THE FREEMAN

Ideas On Liberty

- The Government Spiral
- Privatize the Airports!
- There's No Philadelphia in Europe
- Small Is Awesome

FEBRUARY 1999

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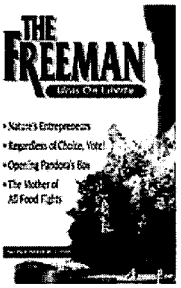
The FREEMAN goes to high school!

Thousands of intellectually curious people, young and old, each year awaken to the world of ideas. Those whose "awakening" arrives in high school often participate in speech and debate. These young men and women deserve an opportunity to consider the great heritage of Western civilization and learn the role that private property, freedom of contract, and freedom of association have played in promoting prosperity and protecting Americans from arbitrary authority.


THE FREEMAN
Ideas On Liberty
• Nature's Entrepreneurs
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FEE's new Speech and Debate Program will make THE FREEMAN, FEE books, and our redesigned web site valued resources for students. Our new newsletter, FREEMAN NOTES ON SPEECH AND DEBATE, will be sent to over 5,000 high schools. Each monthly newsletter will promote THE FREEMAN, encourage schools to subscribe, and feature excerpts from FEE books. FEE's publications and seminars will teach students how to apply these free-market and classical liberal concepts to speech and debate topics.

Students will be introduced to Henry Hazlitt, Ludwig von Mises, and many of today's leading advocates of free-market economics.

Leonard Read, FEE's founder and long-time president, insisted that it is only by improving and refining our own understanding of the free society that over time we come to influence others. Debate students, exert influence whether they understand free markets or not. Many of today's leading free-market scholars competed in high school debate, as did many leading advocates of interventionism and the welfare state. Through competitive training, debate students develop skills to persuade and influence their peers in high school, in college, and throughout their professional careers. (Interestingly, surveys indicate 80% of politicians participated in high school or college debate.)

Leonard Read, Henry Hazlitt and Ludwig von Mises

Instructors at university debate institutes, where thousands go to research debate topics each summer, rarely comprehend economic concepts. And most debate handbooks either confuse or ignore entirely free-market analysis of public policy issues. Most students never hear of private-sector alternatives to failed government programs!

Not all students will be ready for these ideas, but those who are can pursue their curiosity each month in THE FREEMAN, and any evening on FEE's web site. As students learn to build free-market debate cases, they will in turn encourage other students to consider these exciting ideas.

Please consider supporting FEE's new Speech and Debate Program. For further information, contact Gregory F. Rehmke, FEE's Director of Program Development (grehmke@fee.org), or see FEE's web site (www.fee.org).

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THE FREEMAN
Ideas On Liberty
February 1999 Vol. 49, No. 2

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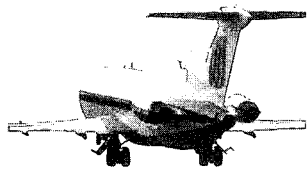

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THE FREEMAN
Ideas On Liberty

Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533
Phone (914) 591–7230 FAX (914) 591–8910
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FEE Home Page: http://www.fee.org

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The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533. FEE, established in 1946 by Leonard E. Read, is a non-political, educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501(c)(3) tax-exempt organization.

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The costs of Foundation projects and services are met through donations, which are invited in any amount. Donors of $30.00 or more receive a subscription to *The Freeman*. For foreign delivery, a donation of $45.00 a year is suggested to cover mailing costs. Student subscriptions are $10.00 for the nine-month academic year; $5.00 per semester. Additional copies of this issue of *The Freeman* are $3.00 each.

Bound volumes of *The Freeman* are available from The Foundation for calendar years 1972 to date. *The Freeman* is available in microform from University Microfilms, 300 N. Zeeb Rd., Ann Arbor, MI 48106.

PERSPECTIVE

Monster

Rule No. 1 for slaying the Hydra: *slay* it.

Don't just cut off one—or even a few—of its heads. That's not good enough: the head might grow back. Kill it *dead*. How many times do we need to be taught that lesson before we learn it?

During the presidency of Ronald Reagan the Department of Justice ended the long, unjust, and wasteful antitrust case against IBM. Moreover, antitrust prosecutions dropped significantly. This happened because Reagan's team included an antitrust staff heavily influenced by Chicago-school critics of antitrust theory and practice. Having sipped from the cups of Yale Brozen and then Robert Bork (whose *Antitrust Paradox* made a deep impression), the staff understood that the history of antitrust prosecution was mostly a history of government's going to bat to save weak competitors from consumer-pleasing companies. It was about protectionism, not monopoly.

But the Justice Department people did not object to antitrust in principle. So while they abstained from interfering with mergers and other activity that previously would have summoned the government's wrath, they did not seek repeal of the government's authority to prosecute companies for peaceful activity. The Hydra was sedated, not slain. When the Clinton team replaced the Reagan team, the Hydra awoke. Ask Bill Gates.

Agriculture is another example of reforming the Hydra. A couple of years ago congressional Republicans boasted that they had put the appalling system of farm subsidies on a seven-year track to oblivion. They sappily called their bill the Freedom to Farm Act. But in the last session, with farmers' incomes off and the election bearing down, the GOP-run Congress did a one-eighty. Farm subsidies were nearly doubled. The head grew back.

In the 1970s the rock group Steppenwolf performed an intelligent song about America and its government called "Monster." The chorus was, "There's a monster on the loose. It has our heads in a noose." Regardless of

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good intentions, most members of Congress who pay homage to the free market don't understand that you can't phase out a monster over seven years. If you try, you deserve to get bitten. But the rest of us don't.

* * *

Most people seem to believe that if the government were not regulating safety in air travel, airplanes would routinely fall out of the sky. Eric Nolte, a commercial airline pilot, shows that this belief betrays a woeful failure to understand how a free economy works.

What to do with a piece of property should be a fairly straightforward matter. But when the property is a decommissioned government-operated military airport, the simple becomes the hopelessly complicated, as Tibor Machan demonstrates.

The European Union. The new euro currency. What is going on in Europe? Norman Barry compares the ominous process of Euro-centralization with the American constitutional experience.

Pope John Paul II's trip to Cuba last year was remarkable in many ways. One of them had to do with what the Pope said about family and education in Castro's paradise. David Boaz says America's education establishment should have been listening.

President Clinton says "save Social Security first." But should it be saved at all? The intrinsically flawed pay-as-you-go transfer program is given a thorough going-over by Harry Dolan.

Trust in government is at an all-time low. Those who lament this state of affairs chide the people for their wariness. But Dwight Lee and Jeff Clark argue that government is only getting what it deserves.

The 1998 winner of the Nobel Prize in economics is an Indian-born economist who favors government intervention to improve the lot of the people. Barun Mitra contends that India has had enough of that already.

Ludwig von Mises is reputed to have said that government is the only institution that can take a useful commodity like paper, slap some ink on it, and make it worthless. But that paper is imposed on us with the magic words "legal tender." D. Alexander Moseley wonders if it is time to banish those words.

The Big Corporation is the bogeyman of every socialist and lesser interventionist. But not to worry, writes Max More, because the market process and technology favor decentralization and competition.

Beware cost-benefit analyses for government programs. As Karen Selick points out, they stand on a foundation of quicksand: namely, the erroneous principle that one person's costs can be compared to another's benefits.

The University of Wisconsin was once a bastion of free speech. Then Donna Shalala, the future secretary of health and human services, took over. Jon Sanders says it's been downhill ever since.

He was a nineteenth-century American individualist who battled for free speech and the right of women to be as free as men. At age 75 he was sentenced to a year at hard labor for his trouble. Wendy McElroy chronicles the life of Moses Harman.

Our intrepid columnists, Lawrence Reed, Doug Bandow, Dwight Lee, Mark Skousen, and Charles Baird, take on government airports, the folly of alliances, business honesty, Amartya Sen, and the International Labor Organization. George Selgin looks at the case for a worldwide central bank and implores, "It Just Ain't So!"

Book reviews this month scrutinize urban education, taxation, early black entrepreneurs, the costs of war, enviro-capitalism, anti-science, and economics and the law.

—SHELDON RICHMAN

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THE FREEMAN
Ideas On Liberty

We Need a Global Fed?

It Just Ain't So!

Some economic pundits see every instance of economic disorder as proof of the defects of capitalism and of the need for more extensive government regulation of the economy. It never seems to cross their minds that government regulations might even *destabilize* markets. A recent example of such thinking comes from Jeffrey E. Garten, dean of Yale's School of Management, who in the September 23, 1998, *New York Times*, urged creation of a global central bank to stabilize the world economy.

Garten begins with a summary of U.S. financial history that would make any economic historian blush. From the Civil War to the 1930s, Garten writes, the American economy "was an uncontrollable Darwinian process" marked by frequent booms and busts and "countless bank failures." Then, to every right-thinking citizen's vast relief, the federal government stepped in, creating the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, and "most important, the Federal Reserve." The "harsh, invisible hand of Adam Smith" was thus moderated, and the business cycle brought under control.

So America's financial system was unregulated before 1930? It just ain't so! In truth, Civil War legislation nearly wiped out the antebellum state banking industry, setting up new national banks that were forced to back their notes with government bonds. Eligible bond collateral became increasingly scarce during the last quarter of the nineteenth century. Over the course of any year, such banks were prevented from meeting seasonal peaks in currency demands. The result was an inelastic stock of national bank currency, which gave rise to serious "currency shortages" in 1884, 1893, and 1907. Government regulation thus played a key role in the "destructive business cycles" that Mr. Garten so unhesitatingly blames on the invisible hand.

In addition to setting unnatural limits to the stock of currency, the government also prohibited national banks from setting up branch networks. This resulted in the proliferation of thousands of under-diversified and failure-prone banks. In Canada, where chartered banks were free to issue notes and to branch nationwide, bank failures were few and far between, and not a single bank failed during the Great Depression. In the United States, by contrast, several thousand banks failed during the 1930s alone, and almost all of them were "unit" banks lacking any branches.

Canada, it should be noted, established a central bank in 1935. Economic historians still wonder why, since its monetary system had withstood the depression better than those of other nations having central banks, including the U.S. system. Mr. Garten suggests that central banks such as the Fed prevent business cycles. But the United States suffered a serious downturn in 1921 and its most serious depression of all starting in 1929, notwithstanding the Fed's establishment in 1913. The years since World War II have not witnessed another Great Depression, but the business cycle has hardly disappeared, and secular *in*flation has become an additional problem.

The truth is that in combating financial crises, central banks have proven to be highly costly and unreliable substitutes for structural improvements in the banking industry, namely, branch banking, competitive note issuance, and foreign bank entry. Central banks have all too often undermined the solvency of private financial firms. The U.S. savings and loan

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industry became insolvent in the early 1980s mainly because of Fed-sponsored inflation, which dissolved the value of long-term home mortgages negotiated a decade or more before. The S&L mess was worsened by the perverse effects of deposit insurance, administered in this case by the Federal Savings and Loan Insurance Corporation, which subsequently failed. So much for the stabilizing effects of "progressive" New Deal financial regulations.

According to a recent study by Kurt Schuler, central banks have done a poorer job historically at promoting low inflation, exchange-rate stability, open exchange markets, and economic growth than non-central banking arrangements, including free banking and currency boards. Indeed central banks offer only one clear advantage over these other arrangements: the ability to print money for their sponsoring governments. And that is one advantage the public can live without.

Seemingly unaware of the role national central banks have played in generating financial turmoil around the world, Mr. Garten can think of no better solution to the world's financial troubles than a *global* central bank. He does not appreciate the link between central-bank pegged exchange rates and speculative currency runs like those recently experienced in Southeast Asia (runs to which non-central-bank arrangements, such as currency boards, are invulnerable); he does not consider the possibility that Japan's present slump may be the payback for its aggressively expansionary monetary policy during the 1980s; and he doesn't contemplate the fact that Russian bank depositors might not have to watch their savings gradually erode were they free to do business with foreign banks. Worse still, Mr. Garten somehow imagines that the errors of national central bankers would somehow be avoided by an international bank, as if ignorance and short-sightedness were unable to transcend national boundaries.

Take Russia as a case in point. From June to October 1992, Russia's central bank tripled its lending to commercial banks. Most of this credit was in turn re-lent, *at a loss*, to the banks' own state-enterprise owners! The losses were then made up for by Russia's finance ministry. In the meantime, genuinely private Russian firms went begging for funds.

Eventually, the massive flows of central-bank credit began to reduce the value of the ruble, undermining Russian banks' ability to pay their foreign debts and rendering them that much more insolvent. And how has Russia's central bank proposed to resolve the crisis? By lending still more credit to commercial banks that should have been declared insolvent long ago!

Would a global central bank help? Not at all. On the contrary, such a bank would merely encourage Russian authorities to continue their perverse policies, by forcing citizens of other countries to bail out an essentially corrupt system.

Instead of performing their self-assigned task of stabilizing national financial markets, central banks have routinely attempted to prop up unsound banking systems with easy money. Jeffrey Garten believes that the cure for this failure is a bigger, better central bank, capable of acting as a world "lender of last resort," when in fact loans from such an institution would only make it easier for national governments to delay needed financial market reforms. Perhaps Mr. Garten believes that a global central bank would rise above domestic politics, resisting any pressure to bail out insolvent banks. But the record of existing central banks, and of the IMF and World Bank for that matter, provides no grounds for such optimism.

On the contrary, experience suggests that a global central bank would quickly be captured by international banking interests and that it would serve those interests (rather than the interest of the general public) by rushing to guarantee their loans even when doing so would be tantamount to rewarding irresponsible government policies and banking practices.

So Mr. Garten, kindly spare us a world central bank: your quaint belief that, when it comes to regulating financial markets, governments can never go too far, just ain't so.

—George Selgin
Department of Economics
University of Georgia

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THE FREEMAN
Ideas On Liberty

The Government Spiral

by Eric Nolte

The graveyard spiral is a maneuver known to students of airplane accidents as one of the most common reasons that inexperienced pilots unwittingly kill themselves.

In this utterly preventable maneuver, a pilot untrained to fly on instruments flies into clouds. Disoriented and suffering tunnel vision, he doesn't notice the airplane's bank. At this point, the airplane's inherent stability has not yet become overwhelmed by the ham-fisted exertions of the poor pilot. If he would just let go of the airplane, it would right itself, but he grimly hangs on, with the plastic of the control wheel oozing out from between his ever-whitening knuckles.

The airstream noise gets louder, causing him to pull back even harder on the control wheel because he thinks that simply raising the nose will pull him out of the dive. But this doesn't counter the fundamental problem, which is that the wings are banked. Pulling back on the wheel, heedless of the bank, tightens the turn. With the noise level of the dive up to the roar of a rock band in live performance, the airspeed and tachometer needles are pegged on the red lines, and the witless aviator hauls back on the controls with a mighty heave. The tail breaks off. He may wait as much as two minutes before impact with the earth puts an end to his terrified and uncomprehending ignorance.

Eric Nolte is an airline pilot, a writer, and a classically trained pianist and composer of contemporary concert music. E-mail him at ericnolte@compuserve.com.

The way out of a graveyard spiral is to level the wings, reduce the power, and ease up on the nose. But you first have to know what has gone wrong.

Regulating Blind

Government regulation is like a graveyard spiral: you know something is dreadfully wrong, but unless you understand the signals, there is no way out. Regulation blinds an economy to signals comparable to an airplane's pitch and bank, signals that would let producers and consumers adjust their activities in response to their desires and available resources.

All too many people who otherwise understand the virtues of a free market become committed socialists when they reserve an airline seat. When they think of placing their precious hide in some fragile tube of aluminum hurtling along at nine miles a minute, six miles above terra firma, while dodging all the forbidding forces of Zeus and Mother Nature, their guts turn to battery acid. Suddenly they are eager for Big Daddy Government to protect them from all those capitalist pigs at the helms of airlines, who everybody knows are immoral, greedy profiteers who would sell their children to cannibals for the right price.

A recent *USA Today* debate on airline safety offered the political mainstream's usual false alternative between lots of government and *lots and lots* of government. The editors

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held that too many violations go unreported, a situation they said would end with more Federal Aviation Administration inspectors wielding greater power to issue fines on the spot.

The editors lumped together every kind of violation. But not all violations are equal. Failing to dot an "i" in the aircraft logbook is a violation of federal aviation regulations; so is failing to install the bolts holding on the horizontal stabilizer. When these transgressions come to light, the public is scandalized to hear that there were *two violations*!

FAA administrator Jane Garvey, in her rebuttal to the editor's call for more regulation, correctly pointed to the dazzlingly good safety record of the airlines: 3.6 billion people on 55 million safe flights. Sleeping in your own bed is more dangerous! She credited government regulation.

That's a logical error, like concluding that x causes y because x precedes y. Goofy may suffer a streak of bad luck after breaking a mirror, but this conjunction of events is insufficient to show a causal connection. While the airlines' safety record is indeed impressive, that success is not half so impressive as it could be without government regulation. Allow me to explain this provocative assertion.

I have studied economics, history, philosophy, politics, and psychology for many years, and I have flown airplanes for 33 years. I know the aviation world firsthand. I fly DC-10s for a major passenger airline that uses these 300-seat jumbo jets to serve destinations all over the world. I have seen the inside workings of two regional and two major airlines. Significantly higher levels of safety will not be achieved by passing laws for our own good that threaten and intimidate peaceful people into behaving as the regulators decree.

Government Caprice

The federal aviation regulations comprise many volumes of boilerplate legalese that is variously interpreted by every regional office of the FAA. Despite the best will in the world, any pilot or mechanic can be found somehow in violation of something at any time. The interpretation of a regulation may have as much to do with an inspector's digestion as with the actual wording of any particular edict. This arbitrariness gives to regulators the power to examine each case "on its merits" and to enjoy the power to act with a "flexibility" that would delight a KGB agent. James Buchanan and F. A. Hayek have shown that such arbitrariness, which is the result of institutional incentives, frequently attracts those who lust after power.

When the regulators themselves cannot agree on what the rules mean (as is famously the case with such other documents as the Internal Revenue Code), then the rule of law has given way to rule by the arbitrary whims of those enforcing the police power. Those of us who are regulated then do business at the discretion of the government.

Most Americans would find it asinine to suggest that we live in a dictatorship, but what else can it mean when government forbids anyone to operate without its explicit blessings, or calls your ability to act peacefully on your own behalf a "privilege" granted by its largesse, and dictates—through the regulations of its dozens of agencies—virtually every detail of how a business is allowed to operate? The economic systems of Germany and Italy in the 1930s provided for private ownership of business, but the government dictated who could sell what to whom at what price, and the government decreed who, of which race, could be hired at what wages. If the soul of ownership is control, then we are experiencing a shift away from private ownership to state control of the means of production.

To insure that airlines fully complied with every regulation would require an inspector from each government agency with jurisdiction over the activity to hover diligently over each employee. But, as one wag put it, if people are too rotten to act responsibly, what makes anyone think the inspectors are any better than the inspected?

Lulling Consumers

Many customers mistakenly reason that if an activity is regulated, it must be safer than it would otherwise be. But government regulators don't make people safe. Aviation safety

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results from the combination of people's own prudence as passengers and an economic system in which enduring success depends largely on how well airlines satisfy their customers' desire to travel affordably, conveniently, comfortably, and safely. Regulators can be duped by fraudulent paperwork and other antics. But customers, given a choice, can seldom be burned more than once before they turn elsewhere.

What best promotes these safe and pleasing outcomes? The free market. By "free market," I don't mean our mixed economy, the unholy marriage between big business and big government, in which special interests vie for success by lobbying for legislative advantages over their competitors instead of by satisfying their customers better than those competitors.

The elements of freedom in the mixed economy allow people to coordinate their activities and resources by mutual and voluntary action. When it intervenes, government forbids people to make voluntary choices according to their assessment of what will work best. Every action within the economic process is ultimately indivisible, as Ludwig von Mises pointed out so lucidly. Whether choosing a material, a supplier for an engine nacelle, a city to serve, or a price to charge, each action ultimately must be directed by the will of a single mind: that of a government bureaucrat or of a private individual. The idea of a "partnership" between business and government is as absurd as the notion of a partnership between a planter and the slaves who pick his cotton. In any disagreement, who gets the final word?

The Chimera of Risklessness

There is no such thing as absolute safety, contrary to the wounded, strident protests of such groups as the National Resources Defense Council, which finds even the tiniest risks anathema. The relevant questions are: how much safety, at what price, and who decides? So long as a legal system exists to protect individuals from violence and fraud, the safety of the flying public would best be served by the outright liquidation of the FAA.

"Oh, come on, now!" I hear lots of people protesting, with the exasperation of a practical, action-oriented American who hates pointy-headed theorizing. "That's voodoo economics! Ivory tower theory! Get real! What will protect people from fly-by-night predators calling themselves an airline?"

Disbanding the FAA would inform the public that its safety depends on its own judgment. In fact, this has always been the case, even when we think that regulators have done all our properly vigilant and wary thinking for us. Of course, it is absurd to expect ordinary people to become airline experts before buying a ticket. So how would they choose safe companies?

The power of reputation would once more matter hugely. A good reputation is not a perfect guarantor. But neither is the FAA. And I for one am happier with a sterling reputation maintained over a long time than with a government bureaucrat's stamp of approval. A good reputation is extremely hard to win—and quite easy to lose.

No airline with a desire to succeed in the long term could operate fast and loose with safety, because passengers would shun it. This is not just abstract theorizing. Observe how an outstandingly successful start-up like Air Florida found itself virtually without passengers from the day after its fatal crash of a 737 at Washington National airport until it financially bled to death shortly afterwards.

More technically accurate assessments of airline performance would be widely available through rating agencies similar to the Consumers Union, Moody's, Standard and Poor's, or Underwriters Laboratories. In the absence of the FAA, these companies would step forward to judge airlines, because the desire to stay safe would create a demand for this knowledge and the lure of profits would produce it.

Another powerful incentive for aviation safety in a free market is that no insurance company would dare cover an airline that operated without prudent procedures: the insurer would go bankrupt for covering a carrier that crashed airplanes willy-nilly.

Of course, a fraudulent start-up might somehow win capital enough to begin operations.

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Con men have swindled people since the dawn of time. But solid research shows that while sleazy operators can fleece some folks for a little while, customers wise up. No company in a relatively free market has ever achieved any huge and enduring success without winning the continuing satisfaction of its customers.

In a free market, money changes hands because producers and consumers expect to be better off for the deals they make. This too is not just abstract theory. Without this expectation, they do not do business, absent a club over their heads. The purpose of government is solely to protect every individual's right to life, liberty, and property—a purpose it accomplishes by punishing fraudulent, predatory, and violent crooks.

Finally, here is the most important argument for disbanding the FAA and other regulatory agencies: the safety engendered by innovation. Regulation always benefits the status quo, the fat cats already in business. The status quo tends to fossilize a given level of technology with laws that make innovations difficult to implement.

Consider one among many persistent and annoying examples: airlines are chronically late out of some cities. Normal, occasional mechanical failures and company mistakes don't explain this problem. So why does it happen? The reason largely is that the FAA's air traffic control system can't handle the traffic.

Why is that system the world's largest consumer of vacuum tubes? It needs them in the antiquated radar systems. Why hasn't a more modern system been devised? Because air traffic control is a secure government monopoly, like the post office, and therefore has no incentive to accommodate itself to the preferences of its users.

Money is not a problem. We airline passengers have paid billions of dollars in ticket taxes for 40 years, ostensibly collected into the airport and airways trust fund to improve equipment and facilities. But the fund is a political football. Moreover, it is used to mask the full enormity of the federal government's plunder: in reports to the public, this money is subtracted from the federal debt!

By contrast to air traffic control's ancient technology, commercial airliners, created by companies that do stand a chance of going broke, haven't sported any vacuum tubes for nearly 40 years.

It was the Wright brothers, not Big Brother, who invented the airplane. Before long, Big Brother told Wilbur and Orville they needed a pilot's license. Of course, Big Brother's own efforts at learning to fly, contemporaneous with the Wright brothers, involved subsidizing Samuel Pierpont Langley, whose flying machine, launched repeatedly from a houseboat in the Potomac, did not fly so much as it tumbled into the river on each occasion. □

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THE FREEMAN
Ideas On Liberty

On Airports and Individual Rights

by Tibor R. Machan

For a couple of years, Orange County, California, has been buzzing with controversy over what to do when the El Toro Marine Air Base is closed. The question on everyone's mind is whether it will be transformed into an international airport by the local authorities. Airports of different sizes are being considered, but there are many citizens who would just as soon avoid the troubles they associate with a new airport.

In our time, such an issue is decided by a combination of federal, state, county, and local bureaucracies following various rules that have emerged over many years of similar haggling. Everyone considers the outcome a matter of public concern, and each citizen supposedly has an equal right to have his or her ideas implemented. Nevertheless, the authorities will make a decision driven by the special interests with sufficiently large constituencies and funds to make a serious difference.

In fact, there is no "right" disposition because the valid concerns of all the people expressing their demands are quite incompatible. The objectives of environmentalists, business people, and residents with various interests—the arts, commerce, education, science, travel, and more—are all over the map, and none can be given any rational public priority, despite what those who speak of the "public interest" would have us believe. The simple fact is that there is no public interest involved here. All interests are private and vested. The only bona fide public interest is one that actually benefits everyone equally. And there are very few such projects in any community—mostly they amount to keeping the peace and preserving the rule of law.

Resolving the Unresolvable

But could it be otherwise? Might there be some way of dealing with an issue of widespread yet still essentially conflicting concerns without several groups of people getting the short end of the stick?

Indeed, there is. Briefly, it involves the strict, unfailing protection of individual rights, specifically the right to private property.

Consider the proposal to have an airport in a community. How large should it be? Who will pay for it? And how should affected third parties be treated? In a system of private property rights, those who own the land in question have the authority to decide how it will be used. But that is by no means a simple matter.

For example, in a system of private property rights the use of a parcel of land as an airport may not place unwanted burdens on third parties—just as you may not dump trash on your neighbor's property. Thus, the operators of the airport may use it only in ways consistent with the equal property rights of their neighbors. Among other things, that means

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the operators will have to avoid impositions on their neighbors or offer them satisfactory compensation for the hardships.

One way to violate rights is to impose unreasonable noise on others. Serious noise during the night, for example, when folks are reasonably expected to be getting their rest, is a violation of individual rights. During the day the same degree of noise would not be a violation because nearly everyone is making noise as they go about their business.

Or take air pollution. At a certain level, "polluting" the atmosphere is normal—living itself produces waste that cannot be avoided. Yet to dump excessive, unreasonable levels of air pollution on third parties—levels not normal within a given realm—is to violate their rights. The details may be difficult to ascertain. But that's why we have courts and arbitration groups.

Rights Constrain Activity

Some people will say that stringent protection of rights would lead to small airports, at best, and many constraints on construction. Of course—but what's so wrong with that?

Perhaps the worst thing about modern industrial life has been the power of political authorities to grant special privileges to some enterprises to violate the rights of third parties whose permission would be too expensive to obtain. The need to obtain that permission would indeed seriously impede what most environmentalists see as rampant—indeed, reckless—industrialization. But it could also significantly impede environmental enthusiasts who gladly violate other people's rights in striving for their objectives (which at times involve returning to a pre-industrial age).

The system of private property rights—in which building, traveling, farming, woodcutting, and all other kinds of other human activity must be conducted within one's own realm except where cooperation from others has been gained voluntarily—is the greatest moderator of human aspirations, keeping them in balance with the diverse and reasonable aspirations of all others. In short, people may reach goals they aren't able to reach with their own resources only by convincing others, through arguments and fair exchanges, to cooperate.

Unfortunately, most special-interest groups —business, environmental, scientific, educational, artistic, and so on—construe their own objectives as superior to those of others. In the case of the El Toro facility, each side tends to believe that its cause is just and that the others are simply using financial and political muscle to thwart it.

In fact, however, many objectives are equally sound and should be carried out—within the limits of individual rights. Look at how this system of rights works in two areas of life: religion and publishing. Many different religions manage to co-exist in reasonable harmony, mainly because each group is able to operate unbothered within its own realm. Many diverse publications also manage to co-exist harmoniously. This, too, is largely because publishing organizations have the right to operate their own facilities and sell their own products unimpeded by the political and bureaucratic processes that govern broadcasting, public education, beaches, parks, and forests. In those areas, individual rights do not rule. Instead, there is a semi-democratic approach in which, at the end of the day, most people are left dissatisfied. Such is the "tragedy of the commons," especially in a country where most people implicitly (if inconsistently) believe the individual's pursuit of happiness is important.

There is, in short, no satisfactory answer to the El Toro controversy within our system of largely politicized social decision-making. But we are not necessarily stuck with this state of affairs. Eventually, we might transcend it. □

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Privatize the Airports!

Waiting in long lines for everything from a boarding pass to a cheeseburger. Slow luggage delivery. Expensive parking. Jammed concourses. Surly workers. Small, dingy restrooms. Long walks from one flight to another that leave you worn out, with the only "consolation" being that the connecting flight is delayed anyway.

All that may sound like a scene from a Woody Allen movie set in some banana republic, but to midwestern travelers it rings with familiarity. It's just another day at Detroit Metro Airport, owned and operated by Wayne County, Michigan.

Thirty-six U.S. airports recently commissioned a survey of 90,000 passengers, who ranked Detroit dead last for overall quality. The poor rating comes despite hundreds of millions of dollars and many commendable efforts by county and airport officials to make Detroit Metro, in the words of director David Katz, "the most friendly place on the planet." Good intentions and lots of nice new carpeting notwithstanding, the aging airport is simply not keeping up with exploding traffic volume. The planned opening of a long overdue additional terminal in 2001 will help, but realizing Katz's ambition probably will require something much more dramatic and fundamental.

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Twenty years have passed since Congress deregulated the domestic airline industry. With airfares down and traffic volume up considerably, airports like Detroit's have experienced problems of congestion and a general decline in the quality of services. Though the general public is aware that *airlines* were deregulated (specifically, their fares and routes), what is much less known and appreciated is that almost all *airports* remain largely outside the marketplace, hostage to political decisions and budgetary concerns of the government entities that own and manage them. For consumers, the market has worked well in the skies. It's on the ground, where politicians and their employees rule the roost, that problems often seem frustratingly intractable.

These problems don't have to exist. A growing number of governments around the world are ending similar troubles, but they're doing so by making more than cosmetic changes. They are realizing that private for-profit firms have the incentive and the expertise to operate airports better than almost any public, politicized bureaucracy. These governments are privatizing the management and in some cases even the ownership of their airports. The results are impressive: privatized airports are far more innovative, efficient, and responsive to consumers than are public ones.

Twelve years after Great Britain sold seven of its largest airports in 1986—including Heathrow, Gatwick, and Glasgow—the program has proven successful by every measure. An astonishing 2.2 million citizens bought 1.4

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billion shares in the newly privatized British Airports Authority (BAA). The flying public has been greeted with an aggressively entrepreneurial attitude aimed at pleasing customers. The airports themselves have undergone substantial physical improvements, and the British treasury has stopped being drained by subsidies.

The British model is spreading. Patrick Cowell, president and CEO of Airport Group International, reports that, "countries from Germany to Australia are now racing to privatize their airports." Operation and management of most of Canada's largest airports—including Vancouver—are now in private hands, as is air traffic control. This past November, I landed at Nadi International Airport in the Fiji Islands within days after it too went private, and I survived just fine.

In the United States there have been no outright sales of major commercial airports, but contracting with private companies for many elements of operation and management is taking off. Allegheny County in Pennsylvania contracted with BAA in 1992 to have it design, build, lease, and manage a retail complex for Pittsburgh International Airport. The resulting "AirMall" of commercial businesses—many entering the Pittsburgh market for the first time—has increased per-passenger sales at the airport from $2.40 in 1992 to $8.10 in 1997, generating at least 900 new jobs.

In 1995, the city of Indianapolis turned over the day-to-day management of Indianapolis International Airport entirely to BAA. The company agreed to a performance-based contract in which certain operations and maintenance-cost savings had to be met before it received compensation. That incentive spurred BAA to work hard to cut costs dramatically. At the same time, the addition of 22 new retail stores, 2,300 new parking spaces, and a shuttle bus service boosted non-airline revenue at the airport by 20 percent, with further increases expected. The next logical step—actually selling a major commercial airport to private owners—may occur within the next decade or so.

If Indianapolis and Pittsburgh—indeed, even London and Fiji—can privatize, why can't Detroit? One reason is the same political inertia that afflicts most government airports. As long as the airport is a patronage machine for the politically well connected, politicians naturally resist any move that diminishes their role.

Another reason that may be particularly acute in Detroit is organized labor. Excessive labor costs because of featherbedding and cumbersome work rules have characterized one Wayne County operation after another. For a privately run Detroit Metro Airport to happen, those practices must give way to more reasonable and hospitable labor-management relationships.

Yet another reason for the lack of privatization is the "Basic Agreement" that exists between Wayne County and the airlines, overwhelmingly dominated by Northwest Airlines. The agreement effectively gives Northwest a veto over the privatization option at Detroit Metro. The airline is worried about landing fees, among other concerns. (Interestingly, landing fees at Indianapolis have remained low and reasonable since BAA took over; the private company understands that gouging major customers is not in its interest.) Wayne County has done what no government should ever do: grant monopoly privileges to one firm when competition was not only possible but would surely have served the public far better.

There is nothing in the stars that ordains airports to be owned and managed by governments. Both economic theory and recent experience demonstrate that. The sooner airports are run by private enterprise, the better. □

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THE FREEMAN
Ideas On Liberty

There's No Philadelphia in Europe

by Norman Barry

The member states of the European Union, in their struggles to find some form of international authority, are going through debates that have a strange resonance with America's arguments about constitutional forms in the late 1780s. However, there has been no Philadelphia—no equivalent European city at which the fundamental issues of freedom and constitutionalism have been thrashed out. Instead, there has been a steady accretion of power to central regulatory authorities in Brussels, either by international treaty or even more significantly, by innovative and creative decisions of the European Court of Justice, which is rapidly becoming what its U.S. equivalent took some time to achieve—the de facto creator of a constitutional order.

Even in its original structure the European Union (it's had various names in the past) was markedly biased toward the executive. The European Commission, executive arm of the EU, has always been more than a civil service. It actually initiates legislation, which is almost routinely passed by the Council of Ministers, the nominal legislature composed of representatives from the member states. The Commission keeps a close watch on them to prevent the emergence of any independent, competitive, and innovative actions. It normally wins cases against member states that it brings before the European Court. Indeed, Brussels, headquarters of the main governmental institutions, is rapidly becoming the capital of a new superstate.

In theory, the original Treaty of Rome (1957), which bound the creators of an economically integrated Europe, was not especially illiberal (in the classical sense). It embodied the "Four Freedoms"—of movement, of goods and services, of capital, and of labor—that constitute the sine qua non of a market society. International regulation was originally limited to the enforcement of the common rules of practice necessary for free economies. True, there were regulations that had immediate legislative impact on member states and directives that were adopted by local legislatures to fit particular circumstances. But in its early days, European-wide law did not automatically take precedence over the laws of member states; so there was some similarity with America's Articles of Confederation, which required the agreement of all states for laws to be nationally applicable. Unanimity was never achieved, and that is why the framers of the Constitution aimed to make federal law *directly* applicable to all Americans, as well as to permit direct taxation by the proposed federal government.

The End of Competitive Governments

In Europe, there was still the possibility of jurisdictional competition, which is the

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essence of federalism, up until 1964, when the *Costa v. ENEL* case was decided; the European Court held that European law was superior to any domestic law with which there might be a conflict. Nothing in the Treaty of Rome validates this legislative capture by the central body. It was simply another example of a centralized court asserting its power to create constitutional law. Ever since, the Court has expanded the power of the Council of Ministers and its legislation. As the American authors of the Anti-Federalist Papers said, a federal court is bound to augment central power at the expense of local autonomy: it reduces the effectiveness of "exit" (that is, voting with the feet), and eventually the domain of individual liberty is diminished. What is the value in moving to another state if all the laws are more or less the same?

Although the European authorities in Brussels have no direct taxation powers (they do have the power to set a minimum level of value-added tax) and the budget is financed by subventions from each member state, one doubts that this will survive very long. Encouragement toward a European-wide income tax will come about through the new European currency, which is under the control of the European Central Bank, an institution that will set an interest rate for all member states that join. (Britain negotiated an opt-out under John Major's Tory government, but this is not likely to survive the newly discovered Euro-enthusiasm of Tony Blair's Labour government.) With a monopoly currency, a central bank, and treaty obligations to maintain various fiscal targets, the tendency toward the promotion of European-wide economic policies will be irresistible. The power to tax, exercised in effect by a centralized state, will complete the European project.

It is a project that subjects European citizens to common economic standards, welfare arrangements, civil liberties, and ultimately most aspects of law. From its inception as the European Economic Community (a mere free-trading area with elementary uniform rules), each stage in its progress has been toward increasing centralization. The major developing institutional arrangements, from the Treaty of Rome itself through the Single European Act (1986), the Social Charter (1989), the Treaty of Maastricht (1993), and the Treaty of Amsterdam (1997), attest to this.

A Benign Beginning

Much of this evolution proceeded under the suitably benign banner of elaborating on the originally modest liberal project of fashioning the principles of a free market as envisaged in the Treaty of Rome. Indeed, some steps could easily find a rationale in public choice theory. For example, under the original arrangements, when unanimity prevailed in the Council of Ministers, progress toward a free common market was successively blocked by member states anxious to preserve anti-market privileges (such as restrictions on capital movement). In good Virginia-school style, qualified majority voting was introduced under the Single European Act, although unanimity remained in certain areas. However, this modest and necessary constitutional innovation soon made possible a mania for "harmonization": many competitive advantages were gradually eliminated so that every member state had to conform to uniform regulations on the environment, labor law, health and safety at work, and so on. A "social chapter" was introduced by which a common welfare policy was formulated.

Most of these standards were, in effect, set by the richer countries, especially Germany and France, which did not want competition from poorer countries anxious to attract capital by offering more favorable regulation. They were, in turn, "bribed" by significant financial redistribution. When countries attempted to avoid these standards, ways were found to thwart them. Britain tried to veto a directive limiting the number of hours in the work week (as proposed, unanimity was required), but it was carried as a health and safety measure, which can be passed under qualified majority rule.

Predictably, the European Court has been a complaisant actor in all this. It doesn't proceed like a common law court, working from case to case and deciding by purely legal reasoning, rather than on political grounds.

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Instead, it tends to regard itself as being responsible for implementing the European "idea"; this of course lets almost anything in. Subordinate courts, for fear of being overruled, correctly anticipate what the European Court would do. Thus a British court struck down laws that exempted part-time workers from the anti-competitive requirements (including generous redundancy payments) enjoyed by full-time employees. It said that since most part-timers were women, the exemption was in breach of various equality provisions in European law. The court even had the audacity to add that this would have no effect on employment.

A great stride down the road to centralization was taken by the Maastricht Treaty (1993). This extended majority voting, introduced plans for a common currency (although not yet obligatory), and confirmed all the movements toward legal uniformity that had been previously established by the Court. The only interesting feature of the ratification process was the ruling of the German Constitutional Court in Karlsruhe. Although the legality of the treaty was upheld, (superficially) strict conditions were laid down for future European integration. Europe was declared to be a *confederation* of autonomous legal systems (to which European law was not superior), and no regulation or directive could abrogate any individual right protected by the German Basic Law.

This nicely contrasted with Britain's much-vaunted sovereignty system, in which its citizens had no recourse to constitutional law once its parliament had signed away legal authority by treaty. (There never was a British constitution.) It may have been a good thing for liberty that sovereignty was effectively renounced, but its replacement is hardly a bastion of freedom. The European Court may have been quite efficacious at striking down some national laws that were obstacles to economic liberty, but it has been singularly ineffective at protecting European market freedoms from regulations and directives from the Council of Ministers; the similarity here with the behavior of the U.S. Supreme Court since 1937 is striking. Whatever the German Constitutional Court may have said about Maastricht, there is no evidence that it will take a stand against European legislation; in fact, with scarcely a murmur it upheld Germany's abandonment of the *mark* on joining the European Monetary System.

What Is Federalism?

What the enthusiasts for Europe do not understand is that freedom is better protected by *competition*, both in economics and law, than by constitutional documents: "exit" always beats "voice" (democratic privileges).[1] This would be so even if the embryonic European constitutional documents were themselves particularly friendly toward liberty. It took the U.S. Congress and Supreme Court about 150 years to integrate the country under one more or less uniform economic, regulatory, civil liberties, and welfare system; Europe has done the same in less than 30. The elimination of constitutional competition in the United States was formally recognized in the notorious *Garcia v. San Antonio Transit Authority* case, where the Supreme Court, in defiance of the Tenth Amendment, said that federalism consisted merely in the fact that the states were represented in the Congress.

Europe has repeatedly given formal obeisance to the (originally Roman Catholic) principle of "subsidiarity," which in the Maastricht Treaty is held to mean that "in areas which do not fall within its exclusive competence, the Community shall take action . . . only if . . . the objective of the proposed action . . . can by reason of the scale of effects of the proposed action be better achieved by the Community." Subsidiarity is a kind of surrogate for genuine federalism. But even as a "parchment" protection for local autonomy, it is feeble. There is nothing like the precision of the original American Constitution, which at least does specify the areas of competence for the federal government and leaves the rest to the states. In Europe there is not even wording that can function as a principle for demarcating centralized authority from local. In any disputed area, the European Court will always side with Brussels.

One solution repeatedly recommended to stem the growing bureaucratization of Europe

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is the closing of its "democratic deficit." It is true that European governmental institutions are not subject to much democratic accountability. The parliament has little or no formal legislative role (in fact, it is a rent-seeker's paradise, as is much of Europe), and the members of the Council of Ministers are only indirectly elected. But more "democracy"—that is, legislative authority for the directly elected parliament—is not the answer. People who make this case repeat the error of Madison, in Federalist 10, on the grand scale. He thought that the "extended republic" would remove the danger of faction because a federal system with divided legislative power would dissipate the malign effects of otherwise unrestrained majority rule. But he neglected the fact that modern-day factions, coalitions of interest groups, would form to plague the central legislature with sectional demands, and dispersed voters would have little rational incentive to control them. The same public choice considerations tell against a democratized Europe, for well-organized and committed minorities always have an interest in formulating (normally redistributive) policies that are inconsistent with the long-run aims and purposes of an apathetic and rationally ignorant populace. Only the objective enforcement of a universal rule of law, which protects property rights as well as civil liberties, can restrain potentially predatory government. Conventional majority-rule democracy is quite inadequate to the task.

One crucial feature of a genuine federal system is the right of exit from the constitutional arrangement: this is justified not merely on the ground of local autonomy but also as a prudential device to restrain the seemingly inevitable centralizing tendencies of all forms of government. For if enough provinces/states object to the actions of the general government, then that government will find it has very little left to govern over. There was always a great doubt about the constitutionality of secession in America, and a hypothetical federal government could go a great deal toward preserving that form by specifically acknowledging the right of exit.

It is continually debated now whether Britain (the least enthusiastic of member states) could *legally* leave the European Union. That question would appear to be answered by an obscure clause in the as-yet-unratified Treaty of Amsterdam, where it is declared that the Commission will bring actions against any member state thought to be in breach of its Treaty obligations; the case will be heard by the European Court. These are the two institutions least likely to be in favor of secession. There is, then, no right of exit; it is a permission that is never likely to be granted. Any such action by a member state will therefore be *political*, with all the adverse consequences that will follow from its exercise. Dover Castle may well be Britain's Fort Sumter.

It is not the case that British Euroskeptics are necessarily fanatics for parliamentary sovereignty, the very system that has done so much to undermine the market economy and the rule of law in their country.[2] What they fear most of all is the reproduction of that institutional phenomenon on a much more dangerous scale in Europe. There is no escape from its depredations except by the costly and time-consuming process of amendment by treaty. And the European rent-seekers will always be able to fend off any such move. The only virtue of retaining independent states (which could still bind themselves by minimalist general rules, mainly for promotion of free trade and protection of the right to free movement) lies in the possibility of preserving genuine institutional competition. This strategy has nothing to do with promoting grandiose schemes for a "more perfect union." □

1. See R. Vaubel, *The Centralisation of Western Europe* (London: Institute of Economic Affairs, 1995).

2. See my "Sovereignty, the Rule of Recognition and Constitutional Stability in Britain," in *Hume Papers on Public Policy*, vol. 2, no. 1, 1994, pp. 10–27.

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THE FREEMAN
Ideas On Liberty

Come to America, John Paul

by David Boaz

You don't have to be Catholic to admire Pope John Paul II's role in undermining communism in Europe and his courageous visit to Cuba last year. Who else in the world could make Fidel Castro broadcast attacks on communism?

But some of the pope's most significant remarks in Cuba were almost lost in the media coverage, which focused on the delicate confrontation with Castro. Among John Paul's most provocative comments were those on education. Speaking at a mass in the city of Santa Clara, the pope called on parents to take back the responsibility of educating their children and chided the Cuban state for subverting the family's responsibility.

The pope's words found a ready audience among Cuban parents dissatisfied with the communist-run schools. But they are worth pondering in the United States as well, for they prompt some difficult thoughts about our own school system. Here's what the pope told millions of Cubans in his televised mass:

> Parents must be acknowledged as the first and foremost educators of their children. Their role as educators is so decisive that scarcely anything can compensate for their failure in it. . . . It is true that in the area of education, public authority has certain rights and duties, since it must serve the common good. Nevertheless, this does not give public authority the right to take the place of parents. Consequently parents, without expecting others to replace them in a matter that is their own responsibility, should be able to choose for their children the pedagogical method, the ethical and civic content, and the religious inspiration which will enable them to receive an integral education. They must not expect everything to be given to them; they should assume their mission as educators while seeking opportunities and creating adequate structures within civil society.

The pope's gentle but profound words were correctly understood as an indictment of Castro's schools, which teach children socialism, atheism, and anti-Americanism, no matter what their parents' values may be. Indeed, there's no question that in Cuba and other communist countries, the essential purpose of the schools is precisely to eradicate all traces of the parents' values, which are often religious or capitalist, and replace them with Marxist theory and submission to the communist state. All Americans, not just Cuban-Americans, must fervently hope that the pope's message will help to liberate Cuban children from the statist indoctrination of Castro's schools.

Does the American System Measure Up?

But how well does the American school system meet the pope's standard? Our own schools are mandatory and government run,

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Pope John Paul II

with little room for parental choice or control. Every line of the pope's message can be read as a criticism of our own educational monopoly—and perhaps also as a criticism of American parents who have let the state take over their responsibilities.

The pope says that "parents should be able to choose for their children the pedagogical method, the ethical and civic content, and the religious inspiration which will enable them to receive an integral education." Clearly, most parents can't do that today. Taxed to support the public schools, most parents feel unable to pay a second time for private schools that might better reflect their own values. Despite the Catholic Church's extensive network of schools, many Catholic parents feel too burdened by taxes and other living expenses to heed the pope's call. And of course American parents have virtually no control over the pedagogical method—that is, the style of teaching—used or the ethical values transmitted in their children's public schools. As for religious inspiration, that is entirely absent from American public schools. It's appropriate for government-run schools in a diverse society to avoid teaching religion, but that raises the question of whether the schools should be run by the government.

By the pope's standard, it would seem that American parents are being deprived of the freedom to exercise their responsibility to direct the education of their children. But American parents may find the pope's message a bit uncomfortable, in that it forces them to contemplate whether they are fulfilling their responsibilities as parents: "Their role as educators is so decisive that scarcely anything can compensate for their failure in it"; parents should not "expect others to replace them in a matter which is their own responsibility"; "they must not expect everything to be given to them."

The pope seems to be saying that parents must not relinquish their moral responsibility to direct the education of their children—and must not simply expect other people, or the government, to pay for something that is their responsibility.

That is not to say that parents must school their children at home. In fact, the pope points out that in "assuming their mission as educators" parents will "seek out opportunities and create adequate structures within civil society." In the pope's understanding, "civil society" means all the associations in society—churches, schools, clubs, and businesses—but not the government.

Parents, then, have a moral responsibility to direct the style and content of their children's education, government should not usurp their role, and parents should not expect education simply to be given to them. That's a message we should hear in the United States. The failure of our government-run schools is a direct result of government's taking over a critical family function and parents' abdication of their duty. Let's hope the pope's health will allow him to deliver this message in Washington, D.C., some day soon. □

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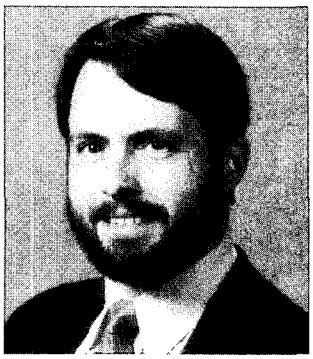

Alliances: What's Friendship Got to Do With It?

America is the "indispensable nation," as Secretary of State Madeleine Albright likes to put it. But while the United States is supposedly indispensable, it can't seem to get along without allies—most of whom seem to think that the purpose of their "friendship" with Washington is to mulct American taxpayers.

The world is awash in U.S. allies. Most western and central European states are members of NATO; most eastern European nations yearn to join the organization. Allies fill East Asia—Japan and South Korea sport formal defense treaties, Australia enjoys regular military consultations, and the Philippines, Singapore, and Thailand benefit from less formal contacts. A score of Latin American nations are members of the decrepit Rio Pact.

Most of these arrangements were fashioned during the Cold War. Today, unfortunately, Washington's collection of allies is simply an economic and security black hole.

For instance, in Europe the United States pays to defend a collection of nations with more people and greater economic strength. To solve European problems of no concern to America, Washington is attempting to reconstruct Bosnia and micromanage the Kosovo civil war.

American policies make even less sense in East Asia, where U.S. forces remain on the front lines in Korea, a tripwire for involvement in any war, even though South Korea has 29 times the GDP and twice the population of the North. Washington is protecting Japan, the world's second-ranking economic power, from threats unknown. Almost every nation in the region expects the United States to solve any conflict arising from such parochial disputes as competing territorial claims over the Paracel and Spratly Islands.

Yet perhaps the most vivid example of the dead-weight loss created by unnecessary "allies" is Israel. There are few nations on which the United States has showered more money and support than Israel. In return Israeli politicians offer nothing but contempt, as evidenced by Prime Minister Benjamin Netanyahu's attempt to extort the release of Jonathan Pollard, convicted in 1985 of spying on America for Israel, as part of last year's Wye River peace negotiations.

At least during the Cold War there was a plausible security argument for a military relationship with Israel. But the United States never enjoyed any practical benefits. Although called an unsinkable American aircraft carrier, military aid always flowed from the United States to Israel, never the other way around.

Anyway, the Cold War is over. The United States can do just fine, thank you, without Israel's help. Indeed, Israel has made Americans less secure. Washington's support for Israel not only encouraged the Arab oil embargo a quarter century ago, but also turned U.S. citizens into targets of terrorists

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the world over. Were it not for America's perceived complicity in Israel's occupation of Palestinian land, Muslim fundamentalists might hate the United States no less, but they would be more likely to ignore than to kill Americans.

What is Israel's claim to the largesse lavished on it? Although a democracy among less free states, it has denied freedom to the Palestinians in its occupied territories for three decades. Anyway, there is no plausible security threat to Israel. It enjoys peace with Egypt and Jordan; however difficult their relations at times, war is extremely unlikely. Israel easily overmatches Syria, which also now finds itself threatened by Israel's unofficial ally, Turkey. And Israel's not-so-secret nuclear deterrent would make even the most extreme countries in the region—Iran and Iraq, for instance—think many times before striking.

Moreover, generous American subsidies have proven costly to Israel. It has one of the most socialized economies on earth, foolishness made possible by Washington's willingness to ship about $500 a person to Israel year in and year out.

This is the lesson of foreign aid the world over. Economic failure creates political pain, which forces economic reform. Foreign aid helps to mask economic failure and thus alleviate political pain—which, in turn, slows or stops economic reform.

Yet Israel retains the master key to the U.S. treasury and a claim to most anything else it wants. It is Washington's biggest foreign aid client, collecting $3 billion plus a year, not counting periodic special subsidies.

Muslim nations are equally undeserving of the aid they receive. The Camp David accords two decades ago promised billions for Egypt, informally pegged at two-thirds Israel's level. That money is almost entirely wasted, funding useless projects and propping up an inefficient, state-run economy. But the "aid," like Israel's subsidy, is beyond criticism.

The Wye accords will lighten the wallets of U.S. taxpayers even further. The Clinton administration has promised billions of dollars in weapons to Israel for use against who knows whom. Washington said it will dump additional billions into the hands of the corrupt and inefficient Palestinian Authority. In fact, the starting demands for economic assistance are $1.2 billion for Israel and $900 million for the Palestinians.

Even worse, the United States will be drawn more deeply into the region's fanatical currents. And the lead agency will be the CIA, reviled around the world for its intervention in the affairs of other nations, such as Iran (we must not forget the coup that helped return the Shah to power in 1953). The CIA will formally participate in a U.S.-Israeli-Palestinian committee "to assess current threats, deal with any impediments to effective security cooperation and coordination and address the steps being taken to combat terror and terrorist organizations."

Oh joy. Terrorism against the United States and its citizens will become even more likely.

Still, even this is not enough for Israeli officials. As the agreement was being wrapped up Prime Minister Netanyahu demanded the release of Jonathan Pollard.

Pollard, a former navy intelligence analyst, turned piles of documents over to America's alleged friend, Israel. Israeli officials, embarrassed at the spectacle of friends spying on friends, first claimed that it was an unapproved "rogue" operation. U.S. officials termed the resulting security breach "massive," and Pollard was sentenced to life imprisonment.

However, with time on his hands Pollard incessantly lobbied Israel to arrange his release. Israel finally admitted its responsibility and granted him citizenship. Then came Mr. Netanyahu's request.

Think of it. The U.S. subsidizes Israel and provides military aid for decades. America endures Arab hatred and terrorist attacks in return. Israel responds by spying on the United States, lying about it, and then threatening to block a peace agreement—for itself—unless Washington releases Israel's spy.

The end of the Cold War warrants a searching review of U.S. commitments around the world. □

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Unhappy Returns

by Harry Dolan

On August 13, 1920, a confidence man named Charles Ponzi was arrested for running a pyramid scheme that had cheated investors out of millions of dollars. Ponzi had promised his investors a 50 percent return after 45 days, and he was able to deliver, at least in the beginning. As news of these fabulous returns spread, more and more investors were lured into the scheme. Of course, the money Ponzi collected was never invested in any wealth-creating enterprise: the "profits" of the earlier investors were paid with money collected from later investors. Ponzi kept his scheme going for less than a year. He was tried and convicted on federal and state charges and served a pair of lengthy prison terms. He was released in February 1934.

Later in 1934, by a kind of charming historical coincidence, President Franklin Delano Roosevelt appointed a Committee on Economic Security to study ways of dealing with financial insecurity, particularly among the unemployed and the elderly. The Committee's recommendations were embodied in the Social Security Act, which Roosevelt signed into law in August 1935. Under the resulting Social Security system, the payroll taxes paid by workers and their employers were not invested in any wealth-creating enterprise; rather, the contributions were used to pay the benefits of retirees.

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The members of the Committee were hardly con artists; they were sober and thoughtful people grappling with a serious problem. In the depths of the Great Depression, the plight of elderly Americans without reliable sources of income or family support was dire. But the remedy the Committee proposed was not some modest and temporary measure designed to relieve suffering: the system they helped put into place has become a (seemingly) permanent arrangement by which wealth is transferred from workers to retirees.

When Social Security was established, it may have seemed plausible that such a system could be made to work. In 1940, when the first monthly benefit payments were sent out, there were only 222,000 beneficiaries. The age at which one could retire and begin to collect benefits was 65, four years beyond the average life expectancy. The system was financed by a relatively small (2 percent) payroll tax, paid half by the employee and half by the employer, and the amount of income subject to the tax was capped at $3,000. Today there are over 43 million beneficiaries. The retirement age is set to rise to 67 in the coming decades—but even so, people are living far longer (around 76 years on average) and thus spending far more time in retirement. The payroll tax, after a series of increases over the years, rests at 12.4 percent, and the amount of income subject to the tax has climbed to more than $60,000—and still, no one expects the system to remain solvent long enough to shepherd today's younger genera-

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tion of workers through their retirement. The Social Security Administration's own best estimates indicate that the system will fall far short of being able to pay its present level of retirement benefits beyond the year 2032.

The Culprit: Demographics

Unlike Charles Ponzi, the Social Security system never promised to make anyone rich—and it hasn't. At present, the average Social Security benefit replaces roughly 43 percent of the beneficiary's pre-retirement income (a replacement level of 60 to 85 percent is needed to maintain one's pre-retirement standard of living). The key to understanding this humble benefit level—and the system's long-term insolvency—lies in the demographic changes that have taken place in the United States since the system's inception.

These changes are actually a broader phenomenon, common to nearly all developed countries, and thus the Social Security crisis in the United States is mirrored by similar troubles in the old-age social-insurance programs of western European nations, Japan, and numerous other countries. The fundamental "problem" is that people are living longer and, at the same time, deciding to have fewer children. This leads to a general aging of the population, as more and more people live to collect retirement benefits—and go on collecting them for longer than ever before—while at the same time, proportionally fewer young people are in the work force paying into the system. The result is a declining "support ratio"—the ratio of current workers to current beneficiaries. In the United States, this ratio dropped from a high of more than 40-to-1 in the late 1930s, to 16-to-1 in 1950, to 3.4-to-1 today; it is expected to fall to 2-to-1 by 2030.

The declining support ratio is problematic for government pension programs because, as noted, these are essentially systems for transferring wealth from workers to retirees. In the language of policy analysts, they are predominantly "pay as you go" plans. Over time, as there are fewer and fewer workers to support each retiree, something has to give: payroll taxes must be increased, benefits must be cut, or the age of retirement must be pushed back (which is really just another way of cutting benefits). In the United States, Social Security benefits were essentially set at a fixed level in 1972, with mandated cost-of-iving adjustments (COLAs) put into place to ensure that benefits keep pace with inflation. The primary method of dealing with the declining support ratio has been payroll-tax increases, more than a sixfold rise since the beginning.

The burden imposed on workers by the current 12.4 percent payroll tax should not be underestimated: many workers pay more in payroll taxes (which are levied from the first dollar of wages, without exemptions) than they do in federal income taxes. And while payroll taxes are nominally paid half by the worker and half by the employer, in reality the worker bears the full impact of these taxes. The share paid by the employer is part of the worker's overall compensation package, and it necessarily reduces the amount of money available for wages and other benefits.

The most recent payroll-tax increase was passed as part of the 1983 Social Security amendments, which were intended to address the looming problem of how to finance the retirement of the "baby boom" generation. At their present level, these taxes generate a yearly surplus, which is invested in U.S. Treasury bonds (held in the Social Security Trust Fund). Thus, the current system is not entirely pay-as-you-go, yet it is still predominantly so, since the lion's share of payroll taxes (80 percent in 1998) is paid out directly to current retirees. Nevertheless, this "partial reserve" method of financing is expected to postpone the system's demise. According to the Social Security Administration's projections, yearly outlays (benefits) will begin to exceed income (payroll taxes) in 2013. At that time, in order to continue to meet the system's obligations, it will be necessary to begin redeeming the treasury bonds in the trust fund. This process is expected to extend the system's life until 2032, at which time the fund will be exhausted and income from payroll taxes will meet only 70 to 75 percent of obligations to retirees.

It is worth noting, however, that most critics of Social Security view the trust fund as a

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dubious accounting device. As they point out, when surplus funds from payroll taxes are invested in treasury bonds, the federal government uses the money to finance its day-to-day operations. When the time comes to redeem the bonds, the government must come up with the money either through other borrowing, tax increases, or spending cuts. Depending on how palatable these various options are, the need to start cashing in the treasury bonds in the trust fund may precipitate a crisis long before 2032.

Poor Investment

The payments that individual workers and their employers make into the Social Security system are not, in a strict sense, investments. Unlike funds invested in equities, corporate bonds, or even savings accounts, payroll taxes are not put to productive use and do not earn a market return for the people who pay them. Nevertheless, those who retire after paying into the Social Security system do receive benefits, and these can be thought of as the "return" on their payroll-tax "investments." If we think of Social Security this way, we see that it has, over the years, become an increasingly bad investment—especially if we consider the rates of return that would have been available through other forms of investment.

During the early phase of any old-age social-insurance system, the typically high support ratio (the high number of workers per retiree) allows an excellent rate of return for retirees—as might be expected, since some people are able to collect full benefits from the system after contributing to it for only a few years.[1] As it turns out, however, the very best rates of return go to those who are between 30 and 50 years old when the program begins. This is because social-insurance programs tend to begin modestly (since a radical new program would be politically unpalatable), and benefits are gradually increased over time. Eventually, as the support ratio worsens, payroll taxes must be increased if benefits are to be maintained at the same level. Workers who come into the system late, after payroll taxes have been increased, will pay much more over the course of their working lives. Their benefits—even if adjusted each year to keep pace with inflation—will represent a terrible return.

Social Security in the United States has followed this pattern. For example, workers who retired in 1975 received, in just two years, benefits equal to their entire lifetime contributions. In contrast, a worker who retires in 2035 will take anywhere from seven to 17 years (depending on his income level) to get back the money he put into the system. That's assuming he lives long enough—and that the system is still around in 2035.

The gravity of the situation for young workers becomes clear when we look at the annual real (inflation-adjusted) rate of return on their contributions to Social Security. This rate is estimated to be 1 to 2 percent for most workers (although it may be as much as 3 percent for the very lowest earners).[2] And the situation may even be worse: economist Martin Feldstein estimates that those who are presently in their 40s or younger will earn a negative return: that is, they will actually receive less in benefits than they and their employers have paid into the system.[3] Compare this with the real rate of return on stocks, which has averaged 7 percent from 1926 to the present, or on a mixed portfolio of stocks and bonds, which comes in at around 5 or 6 percent.[4] The magnitude of the difference means that if workers were free to invest their money, rather than being compelled to contribute to a system that merely transfers their wealth to others, they could earn returns many times larger than those promised by Social Security.

In fact, William Shipman estimates that if workers born in 1970 were able to invest an amount equal to their Social Security contributions in stocks, they would (assuming they earned historically average returns) receive almost six times the benefits they would get under Social Security. Low-income workers would do less well, but would still receive almost three times what Social Security offers.[5]

Harnessing the Market

It is the prospect of these kinds of returns that has led some critics of Social Security to

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call for privatization: they argue that it should be replaced by a system of individualized private retirement accounts, financed (as the current system is) through compulsory contributions. The difference, of course, would be that contributions would actually be invested (in some combination of stocks, bonds, and mutual funds), rather than being paid out as benefits to current retirees. The amount contributed, plus accumulated earnings, would be used to fund the individual's retirement. The model for this type of privatization is the system instituted in Chile in 1981.

Critics of this type of proposal point out that investing in stocks can involve substantial risks—to see this, we need look no farther than the 19 percent drop in the market between July 17 and August 31 of last year. That kind of volatility, critics say, is hardly a recipe for retirement security. The trustees of the Social Security Trust Fund appeal to this sort of reasoning in their 1998 annual report: "Social Security," they write, "is a compromise that assures all workers a modest retirement base on which they can, if possible, add a private pension and personal savings. The tradeoff for this safety is a lower retirement benefit than at least some knowledgeable individual investors might build over their lifetimes."

This is at least half true. The "retirement base" provided by Social Security is indeed very "modest," as we've seen—and is sure to get even modester after 2032 if nothing is done. But would only "knowledgeable investors" reap better returns by investing in private markets than they would through Social Security? In assessing the risks of investing in stocks, we need to look at the long term—and in the long term, things look good even for novice investors, assuming they recognize the limits of their knowledge and invest in broadly diversified mutual funds or stock index funds that track the performance of the market as a whole. Even during the worst 20-year period of stock market returns, which ran from 1929 to 1948, the market as a whole yielded a real annual rate of return of more than 3 percent—which suggests that even under the gloomiest of conditions, workers wouldn't do worse on their own than they would under Social Security. Indeed, if Feldstein is right and workers in their 40s and younger can expect a negative return from the current system, then any investment that merely keeps pace with inflation would offer a better deal than Social Security. If the dollar could be relied on to hold its value, you could beat Social Security's return by stuffing your payroll-tax money into mason jars and burying them in the back yard.

Reform Proposals on the Table

What can be done to address the serious problems facing the Social Security system? Congress is expected to take some action on the matter this year. The two main alternatives that seem to be emerging both involve using the potential gains from investing in stocks to shore up the system without radically altering its basic structure. The first alternative would simply invest some part of the present annual Social Security surplus in private financial markets, in the hope that higher returns would help to cover the shortfall that the system is expected to experience as the baby boomers retire. The best that can be hoped for from this option is to preserve the current system as it stands—to perpetuate the current meager level of benefits, which could not otherwise be maintained beyond 2032.

The second, more ambitious alternative is backed by Senators Daniel Patrick Moynihan and Bob Kerrey. It would attempt to salvage the current system by supplementing it with private investment accounts—into which an individual could divert 2 percentage points of the 12.4 percent payroll tax. Individual workers could choose how to invest the money in their accounts—at least within government-approved limits. The returns from these accounts would be added to the individual's standard Social Security benefits. Since diverting 2 percentage points of the payroll tax would actually worsen Social Security's long-term financial imbalance, the difference would have to be made up somewhere. Accordingly, the age of retirement would gradually be raised to 70 between now and 2029, and any further shortfall would be paid for out of general tax revenues (the plan

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assumes that the overall federal budget will be running at a surplus).

A Better Alternative

Neither of these proposals challenges the fundamental assumption underlying Social Security (and old-age social insurance in general): the idea that society is responsible for ensuring some level of retirement security for all its members. Even a radical Chilean-style privatization plan (one that diverted all of an individual's contributions into a private retirement account) would not challenge this assumption, so long as the contributions remained compulsory.[6]

But the path to security does not lie in surrendering responsibility to society. Indeed, to live a human life is to embrace the responsibility of living long range: it is to realize that there may come a time when one will not want—or simply will not be able—to continue working. Planning for such a contingency is a profoundly moral issue. It is a weighty undertaking; there are any number of things that might go wrong. The assumption behind Social Security is that it is too heavy a burden for any one person to bear, so the collective will relieve the individual of the need to think and plan for the long run.

The irony is that the creators of Social Security failed to think and plan long range. The system they designed has—in less than the span of a human lifetime—reached a crisis. The burden of its payroll tax robs many people, particularly the poor, of the opportunity to make investments that might actually provide them with a comfortable retirement. It represents a deal that no one would accept willingly and that no one should be forced to accept.

The inevitable response to the suggestion that Social Security should be abandoned is that its elimination would betray current and future retirees who have assumed they would receive its benefits. Indeed, elimination of Social Security would require a costly transition. This fact is an indictment of the system itself, and can hardly be used as an objection against the system's critics.

What should ultimately replace Social Security? The Chilean-style privatization alternative mentioned above—essentially a compulsory savings plan—would undoubtedly provide a superior return for workers if it were properly implemented. Yet it fails to challenge the idea of collective responsibility that lies at the heart of Social Security, thus opening the door to large-scale government interference in private financial markets. The temptation to regulate investment for "the good of society" when the future of the nation's retirees is at stake would be strong. What's more, a compulsory private system would share Social Security's assumption that individuals are not to be trusted to plan their own lives. The regimented existence that any compulsory system must impose is, at root, incompatible with human freedom and human responsibility.

The real alternative to Social Security is privatization in a literal sense—the realization that planning for retirement is a private matter, that it should be left to individuals and their families, who would be free to seek the soundest advice they could find and make the best arrangements that were within their means. Such a system—which is really not a "system" at all—would be far more secure than Social Security, since it would not leave people at the mercy of demographics and support ratios—or of politicians. □

1. For an excellent discussion of old-age insurance, from which the account in this paragraph is drawn, see Daniel Shapiro, "Can Old-Age Social Insurance Be Justified?" in *The Welfare State*, ed. Ellen Frankel Paul, Fred D. Miller, Jr., and Jeffrey Paul (New York: Cambridge University Press, 1997).

2. Peter J. Ferrara, *Social Security Rates of Return for Today's Young Workers* (Washington, D.C.: National Chamber Foundation, 1986); Michael W. Lynch, "Retirement Plans," *Reason*, August 1998, p. 56.

3. Martin Feldstein, "How to Save Social Security," *New York Times*, July 27, 1998, p. A17.

4. Testimony by Carolyn L. Weaver before the Senate Committee on Finance, September 9, 1998.

5. William Shipman, *Retiring with Dignity: Social Security versus Private Markets* (Washington, D.C.: Cato Institute, 1995).

6. For details on how a compulsory private system might work, see Peter J. Ferrara, "Privatization of Social Security: The Transition Issue," in *The Welfare State*.

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THE FREEMAN
Ideas On Liberty

Distrust and Verify

by Dwight R. Lee and Jeff R. Clark

Perhaps the most positive legacy of the Clinton administration will be that it further eroded the public's trust in the federal government. Trust has declined significantly since the Great Society programs of the Johnson administration. According to University of Michigan surveys, the number of people who responded that the federal government does what is right "always" or "most of the time" has dropped from 75 percent in 1964 to less than 30 percent in the mid-1990s.

Our view is that this decline in trust is a good thing because it mirrors rather accurately the performance of a government that has become less trustworthy. However, before making our case for less trust in government, we acknowledge that most people see the decline in this trust as a serious problem.

The Cart Before the Horse

People have worried about lack of public confidence in government for a long time. For example, Benjamin Franklin fretted that "Much of the Strength and Efficiency of any Government, in procuring & securing Happiness to the People, depends on . . . the general Opinion of the Goodness of that Government."

This was no doubt a legitimate concern in Franklin's day, when the federal government was undergoing a controversial birth and controlled little of the people's wealth. But today, with the federal government commanding over 20 percent of our income directly through spending, and significantly more through regulation, some are still concerned that confidence in government might be too low to allow it to seize more of our resources. For example, Joseph Nye, dean of Harvard's Kennedy School of Government, worries that "if people believe that government is incompetent and cannot be trusted, they are less likely to provide [critical] resources. Without [these] resources, government can't perform well." Studies investigating the decline in trust, and fueling concern about the consequences, have been published recently by the Kennedy School, University of Virginia, and Pew Research Center for the People and the Press.

These studies sometimes admit that government's performance leaves something to be desired, but suggest that the best way to improve its performance is by restoring trust in it. This puts the cart before the horse.

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Where is the advantage in placing more trust in an organization whose performance does not justify trust? How many people needing heart bypass surgery would trust a surgeon who kills most of his patients on grounds that he will become a better surgeon only if more people trust him?

The only sensible way to restore trust in government is by making it more trustworthy. And a trustworthy government is more likely to be undermined by too much trust than by too little. Indeed, a major reason government performs so poorly is that persistent political influences encourage citizens to put far too much trust in it.

The Arithmetic of Voting

Public trust is easily transformed into political power that will be used to promote private advantage at public expense. The reason is rooted in the simple arithmetic of voting. Voting is an important civic responsibility, and nothing here is meant to suggest otherwise. But in state and national elections, the probability of your vote deciding the outcome is far less than that of being injured driving to the polls. This means that favoring one candidate or proposal costs you almost nothing in terms of sacrificing the alternative. Only in the rare case of a tie is your vote decisive; only then does your vote for one alternative cause you to sacrifice the other.

This arithmetic is important because it explains why charisma and emotion can trump substance in politics. Registering support at the polls for a superficially attractive candidate or a superficially compassionate proposal allows a voter to identify with the glamorous or feel virtuous with little concern about cost or effectiveness. For example, if voting for a proposal to combat "global warming" (or for a candidate who supports the proposal) makes you feel good, you might be tempted to shelve any doubts and vote regardless of the cost to you if it passes, since your vote is not decisive. The more people trust government, the more virtuous they feel when voting for a wide range of government initiatives that end up costing far more and delivering far less than promised.

Exploiting the Public's Trust in Government

The nature of government programs enables well-placed interest groups to capture private benefits at public expense. The Environmental Protection Agency (EPA) has increased the size of its budget by championing command-and-control approaches to reducing pollution. Market-based measures are more effective and cheaper, but require fewer bureaucrats and have been resisted by the EPA. Industry groups (such as the eastern coal industry) have also supported command-and-control approaches to protect themselves against competition (from low-sulfur western coal), at the expense of consumers (higher electricity prices) and environmental quality (more sulfuric oxides in the atmosphere). The list of government activities supported by well-intended citizens, but perverted by organized interests, is painfully long.

Every interest group wants to convince the public that government can be trusted to promote the general well-being by increasing some spending or regulating. The result is a steady stream of rhetoric aimed at making people feel good about trusting government to solve almost every imaginable problem.

Unfortunately, a widespread belief that discretionary government power can and should solve every social problem is incompatible with government's performing well. Such trust leads to politically compelling demands for government to do lots of things it has no business doing, with the result that it does poorly the few things it should be doing.

The best way to make government more trustworthy is for voters to resist the temptation to achieve a cheap sense of virtue by voting for every "virtuous" proposal that comes along. The real virtue is in voting against most government programs (and the politicians who support them), no matter how virtuous those programs are supposed to be.

We need plenty of public skepticism toward government to counter the voters' tendency to support government activities that purport to "do good" with power that will invariably be captured and corrupted by special interests. A trustworthy government requires a healthy measure of public distrust. □

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THE FREEMAN
Ideas On Liberty

Sen or Sense

by Barun S. Mitra

In the battle over economics, the victory of the market seemed decisive. It had not been easy. Since the days of Adam Smith, the world economy had to cross the turbulent waters of colonialism, mercantilism, socialism, fascism, and communism before liberalization, globalization, and privatization became accepted as part of our general vocabulary. But even before the process of consolidation is over, it now seems that free market ideas are faced with insidious threats as never before.

Indeed, the popular appeal of socialist ideas was not primarily based on economic principles but on ethical and political ones—an egalitarian world view. (Discussions rarely focused on the morality of the methods that would be necessary to create such a world order.) On the other hand, many advocates of the free market rarely went beyond economics and utility, and generally ignored the moral basis of the marketplace.

This is best reflected in the criticism of the market that has inevitably followed as the so-called "transition" economies in eastern Europe, Russia, and Latin America have run into rough weather. This criticism has gained considerable credibility after the turmoil in the currency markets in Asia over the past year. Not surprisingly, "liberalism with a human face" has become the new mantra.

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No one today epitomizes this sentiment more than Amartya Sen, the Indian-born 1998 Nobel laureate in economics. In a congratulatory message the president of India, K.R. Narayanan, said, "You have brought to bear upon the science of economics a compassion for the ordinary human being and a vision of an egalitarian world society."

Empowering the Poor

Sen's recipe for inducing long-term sustained growth involves empowering of the poor through education, health, entitlements, and removal of gender disparity. His method for delivering these services is democracy. And he mainly rests his case on the evidence that independent democratic nations have been more successful in eliminating famines than others.

There is much more than a grain of truth in Sen's arguments. However, grains are necessary but not sufficient for a balanced diet. Democracy may be a necessary condition for alleviating poverty, but it is not a sufficient condition. Otherwise, India, the largest democracy, would not have remained in the club of poorest nations of the world.

Let us take a closer look at a few of Sen's propositions in broad context.

Democracies, with periodic elections and a free press, keep elected representatives on their toes and the government more responsive to the population. In times of large-scale tragedies, such as famines or floods, when

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opposition parties and the media are on the lookout for opportunities to discredit the authorities, representatives work overtime to get as much relief as possible to their constituents.

Indeed, so successful has this process been that, today, whether in the United States or India, politicians continually vie with each other to declare some of their constituents victims of one disaster or another—famine, flood, fire, cyclone, earthquake, crop failure, indebtedness, bankruptcy, job loss, child neglect, old age, to name just a few. Pork-barrel politics is the natural outcome of such an approach. After all, if the benefits can be appropriated to a few and the cost distributed among the whole population, it would be irrational not to try to corner as large a share of the "public pie" as possible.

Apart from the social and economic damage it may cause, this approach legitimizes state intervention through control and expropriation, even if only in the "social sectors." Once that approach to governance is accepted, it becomes almost impossible to draw a line, since all such intervention is always justified by some alleged social good.

Moreover, this governance becomes extremely short-sighted, moving from one opinion poll to another, from one election to the next. Such a government is hardly ever in a position to concentrate on programs that require a much longer time frame, for example, education or health, two of Sen's principal concerns. On one hand, he laments the failure of the leftist forces in democratic India to capitalize on their natural constituency among the poor by stressing these two most basic of "entitlements." On the other hand, he points to the success of the non-democratic, socialist economies in those areas, implying an astonishing lack of regard for the methods that were adopted by these countries to achieve that "success."

There is no doubt that education and health care are the two basic tools with which an individual can improve himself. So Sen's concern for those who apparently cannot secure these, and his fear that they may not benefit from a liberalized and globalized economy, need to be addressed.

The Power of Vested Interests

As Sen consistently points out, the performance of the Indian state in primary education and health has been dismal. Indeed, the power of vested interests and pork-barrel politics in the field of education is distinctly visible. For instance, in a country where almost half the population is considered illiterate, higher education is most heavily subsidized! Or at a time when provincial governments can only try to ensure at least a primary school within a reasonable distance of every village, students in Delhi travel almost free to their colleges and universities. Icing on top of their cheap education cake! Another problem is that the content of education has been completely politicized.

Furthermore, there is no real evidence that opposition to liberalization comes from the millions of illiterate, low-skilled workers, an overwhelming majority of whom are engaged in the informal and unorganized sectors of the economy. They provide a range of goods and services—from collecting garbage to manufacturing vehicles—which either the state has failed to deliver despite promises or which the formal sector has been unable to provide. (There is no welfare to speak of.) Clearly, then, the basic problem is not lack of education, but almost total lack of employment opportunity in the formal sector.

According to official estimates, barely 30 million of India's work force of 400 million are in the organized sector. Not surprisingly, it is this small but entrenched minority, who fear the loss of their unearned privileges, that are at the forefront of the anti-reform group. Their share of the national pie is best indicated by the fact that since the 1970s, while the consumer price index increased by about 750 percent, per capita emoluments rose by a whopping 1,600 percent—a remarkable demonstration of the power of vested interests. The only other explanation is an amazing increase in their productivity. No wonder that the quartet of politicians, bureaucrats, organized labor, and businessmen who have benefited from state patronage and thrived in a protected environment are so keen to defend the status quo.

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By adopting the "socialist pattern of development" since the 1950s, the Indian state has been very successful in choking the economy and thereby wasting the most precious of all resources, the spirit and enterprise of her people. As P.T. Bauer, the other development economist deserving of the Nobel Prize, has said, it is policy not poverty that keeps people poor.

The result of Indian socialism has been rampant underemployment, and consequently there seems to be little rational basis for the illiterate to demand better education. Is it any surprise that despite an enrollment of over 90 percent at the primary-school level, the dropout rate after five years ranges between 35 and 40 percent.

Land Reform

Another issue Sen has stressed is land reform. But even the much talked-of land reforms in states like West Bengal have not been able to stimulate growth. Forcible land distribution has led to fragmentation of holding, and productivity has not improved much as a result. This has led to the rise of political brokers in the countryside and forced people to stay on the land. Lower labor mobility has permitted the state government to ignore the virtual collapse of the industrial sector. Bureaucrats are more concerned about preserving the privileges of the existing work force than about increasing employment opportunities. Clearly, land reform in West Bengal has, perhaps unintentionally, helped slow the pace of urbanization, industrialization, and, consequently economic growth. Seen in this light, it should not surprise anyone that West Bengal, which peaked in those respects in 1947, has been sliding over the past decades.

Land reform is necessary. But this cannot be isolated from general economic policy. Today, the state is the largest landlord and is increasingly involved in disputes with indigenous people, whose title to their traditional land is not recognized. Rural communities are being torn apart by contentious litigation and frequent violence. Maintenance of land records by state governments is pathetic and open to rampant manipulation and corruption. Also, land reform cannot be a one-way street to land distribution. There is an urgent need to recognize that productivity, efficiency, and economies of scale are as relevant in agriculture as they are in other sectors of the economy. By obstructing consolidation of landholding in the name of land distribution, India has been spectacularly successful in making agriculture unviable, sealing the fate of the 70 percent of the population that lives in perpetual poverty in our countryside.

To successfully move away from this self-destructive course, a new vision is required. Sen's concern for the poor, the hungry, and the deprived runs very deep. But there is a need to go beyond good intentions, which, though necessary, cannot be sufficient for the alleviation of India's ills. Sen deserves credit for highlighting the need to re-establish the relationship between ethics and economics. However, the ethical premise may have to be quite different from the one Sen proposes.

The Morality of Free Exchange

It must be recognized that voluntary exchange in the marketplace is infinitely more moral than expropriation under the sponsorship of the state. It has to be acknowledged that the best way to empower the poor is to allow the market to operate unhindered so that even the poorest have the widest range of options.

The world has taken over two hundred years just to begin to appreciate the power of Adam Smith's "invisible hand" in economics. Let's hope we don't take another two hundred years to appreciate the morality of the marketplace. It will be a tragedy if after winning the battle over economics, the war is lost on ethics. □

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THE FREEMAN
Ideas On Liberty

Abolish Legal Tender

by D. Alexander Moseley

An advertisement in an English newspaper offers a one-million-dollar bill for sale—at the remarkably reduced price of £29.95 (about $50.00). However, this great deal comes with the words "Not Legal Tender." Thereby the advertisement unwittingly presents the essential problem of national currencies in a nutshell. Two magic words are all it would take for the note to become spending money. Surely, monetary policy cannot be that simple? In an age of government-issued currencies, unfortunately it is.

Government control of national currencies has not been stable or beneficial to say the least. In the last year, currency crises hit the news frequently. The resulting lack of confidence in a nation's currency means that international investments will seek more profitable ventures where the fear of devaluation is not so acute. Devaluation follows from governments' inflating their currencies through central banks and fractional reserve banking; as money is "created," exchange rates are affected and investors have to reconsider their projects.

Traders have long learned to avoid a great part of exchange rate risk by employing currency futures and options. Even so, an unanticipated currency movement can have a deleterious effect on a company's profit forecasts and its investments and employment. The ensuing effects on national economies can be disastrous; yet the cause is not difficult to define. It lies with the uncritical acceptance of legal tender rules. By maintaining those rules, national governments permit their central banks to issue base money—effectively paper, although soon it could be electronic cash—at their discretion. Any central bank has the legal power to print a run of million-dollar bills, define them as legal tender, and create new money out of thin air.

Rippling Effects

The repercussions of legal tender laws are quite visible: by printing paper the central bank inflates the currency. Some of that currency will seep into loan markets, affecting interest rates; some will affect particular price ratios in markets, causing economic dislocations; some will enter the foreign currency markets, reducing the price of the national currency in terms of other currencies. Overall, local prices will rise and the exchange rate will fall. The effects are complicated by the actual paths that the new money takes, but the overall qualitative result can be ascertained—resource allocation is distorted and irrevocable damage done. It does not matter if the central bank's inflation was anticipated beforehand—something that modern macro theory attempts to argue—for no one is in a position to pursue the transactions of every single new note printed. Therefore, no one is in a position to establish the overall quantitative effects until afterwards, at which point the damage has been done.

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February 1999

Countless Wonders

On a recent drive through an affluent San Francisco neighborhood boasting truly spectacular homes, I did what almost every ordinary person does in such circumstances: I wondered to myself, "What can *I* do to earn enough money to be able to afford such a home?" My thinking continued: "To earn such wealth requires that I produce a product that lots of people value more than it would cost me to produce. Okay! Good! I've identified the general formula. Now all I need to do is to think of a product for which people will pay a price higher than my cost of production."

"What can I produce? . . . What can I produce? . . . What creative idea can *I* come up with that will earn me a bundle? . . . What can *I* produce? . . . Think, Don: think, think, THINK!"

Melancholy engulfed me as I drew a blank—the same embarrassing blank that I drew on each of the thousand-and-one previous occasions when I tried to think of a new product or service that consumers would value.

Fact is, I possess absolutely no such entrepreneurial creativity. None. Zippola.

And yet, despite my mind's barrenness on this front, how fortunate I am! How amazingly, breathtakingly fortunate—and wealthy—I am!

My good fortune is that I live in a society in which I benefit immensely and directly from other people's creative ideas—no one of which *I* would have dreamed up in several lifetimes. The distinguishing feature of a depoliticized free-market economy is that it not only inspires creative people to create, but it also inspires these creative people to create things and processes that benefit even me and others who are hopelessly non-creative.

Here's what I mean. I'm writing these words somewhere over the State of Utah as I hurtle toward New York City at a speed of 600 miles per hour. Less than a foot from my arm the air temperature is 50° Fahrenheit below zero. And yet I'm cozy, comfortable, and safe as I sip complimentary gourmet coffee. Two hours ago I was in California; three hours from now I'll be in New York. My thoughts are being recorded (with help from my fingers) on a laptop computer that has more computer power than was on Apollo 11. I can check my e-mail messages by plugging my laptop into the telephone nestled in the seat in front of me.

Each of these wonders—and they *are* wonders!—is made possible by countless creative ideas of people whom I don't know and who don't know me. I am responsible for none of the ideas that

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enable me to write on a computer as I fly safely across the continent. But here I am, the happy beneficiary of these astonishing creations.

What's more, I'm an ordinary American. I'm not rich by modern American standards. But so what? In truth, I'm astoundingly wealthy. I (like nearly all other Americans) can acquire these luxuries in exchange for just a tiny fraction of my work time.

Let's tally up the cost to me, today, of the luxuries that I identify above. The round-trip coach airfare is $338. My new laptop, complete with modem and all of the requisite software for word processing and for e-mailing, costs a total of $2,000. Because I'll probably keep this laptop for at least two years, the *daily* cost to me of this laptop is no more than $2.74 (which is $2,000 divided by the 730 days that there are in two full years). To check my e-mail will cost me about $35 in telephone charges—a figure calculated on the assumption that I'll be on the air-phone for ten minutes (which is far more connect time than I'll probably need).

So what do we have? All told, it costs me a paltry $375.74 to fly from New York to California and back *and* to write this column en route *and* to check my e-mail. $375.74—that's all! A mere $375.74 is all that I paid to do what twenty years ago no one at all could do, and what only four or five years ago only the wealthiest of the wealthy could do.

Yet today laptop computing on a jetliner is so common in Western society that we take it for granted. My fellow passengers are no more astonished to see me typing on my laptop than they would be to spot a pigeon in Central Park.

The 1997 annual report of the Federal Reserve Bank of Dallas is entitled *Time Well Spent: The Declining Real Cost of Living in America*. I encourage you to read this remarkable document. (Note: The Dallas Fed is something of a renegade among government agencies. Its leadership and staff of economists rank among the most free-market-oriented group of scholars in America today.) The report's authors—W. Michael Cox and Richard Alm—document how the real cost of living in America has fallen dramatically over the past century, and how it continues to fall. Cox and Alm measure cost of living by using work time—the amount of time the typical American worker must labor to purchase various goods and services.

Almost any good or service you can name costs less work time today than it cost just a few years ago. For example, in 1984 the typical American worker had to work 435 hours to purchase a personal computer. Today, a vastly more powerful computer is available for only 76 hours of work by the typical American worker. A cell phone in 1984 cost 456 hours of the typical American's work time. A much better cell phone today costs a mere nine hours.

Of course, many goods and services that we today take for granted could ten years ago be purchased at no price whatsoever—such as checking e-mail from a commercial jetliner.

The marvels to which we each have daily access are the product of millions of creative minds figuring out how better to please consumers—by producing new or improved products and by reducing the costs of producing existing products. Many of these creative people earn (and deserve) millions of dollars; some earn (and deserve) billions of dollars; most earn handsome but not princely sums. Everyone, however, in industrial society profits greatly from every market entrepreneur's creativity.

I need not lament that I, personally, have no creative, productive ideas. I have the great good fortune to live in a society that encourages truly creative people to share the fruits of their creativity with me. My blessings are literally too great to count.

Donald J. Boudreaux
President

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FEE Heritage Book Sale

Throughout its history, a number of notable authors have been associated with the Foundation. This month we highlight that legacy by featuring the works of former FEE staff members and Trustees. In each of these books you'll find a discussion of some important aspect of the freedom philosophy. Moreover, each work reflects the studied inquiry of a lifelong defender of liberty.

American Federalism, George C. Roche III. George Roche is now President of Hillsdale College, but prior to going to Hillsdale in 1971, he was Director of Seminars at FEE. A talented historian and biographer of Bastiat, Dr. Roche is also a uniquely capable advocate of individual liberty and free markets. *American Federalism* is one of our older publications, but its message remains imperative. In it, Dr. Roche discusses the intellectual origins of our federal system, how federalism developed in the 19th century and then, sadly, eroded in the 20th. In his concluding remarks, he calls for a return to a decentralized political system and a reinvigorated moral ethic of individual responsibility. This concise pamphlet explains why limited government is the best government—an excellent choice for handing out!

Paper, 46 pages: ~~$1.00~~ **Sale: $ .50**

Can Capitalism Survive? Benjamin Rogge. Dr. Rogge was professor of political economy and dean at Wabash College and a FEE Trustee for many years. He is remembered fondly as a much valued regular lecturer at FEE's Seminars. This truly insightful, clear, and eloquent book is, like *American Federalism*, one of our older titles but, is it ever good! Starting from Joseph Schumpeter's famous hypothesis that capitalism cannot survive because its success inevitably undermines the social institutions that protect it, Dr. Rogge examines the case for economic freedom, the libertarian philosophy, and the nature of economics. He looks at several topics in some detail: money, labor, education, and cities. He concludes with a challenging discussion of FEE's role as a disseminator of these ideas and as a force for change in the United States.

Paper, 329 pages: ~~$10.95~~ **Sale: $5.00**

Faith of Our Fathers, Mary Sennholz, ed. Back in the late 1940s and early 1950s Mary Sennholz (then Homan) worked for FEE's founder, Leonard Read. She returned to the Foundation in 1992 with her husband, Dr. Hans Sennholz. From 1992 until 1997 Mrs. Sennholz helped the Foundation with its book publication program. *Faith of Our Fathers*, published in 1997, contains essays by Clarence Carson, Ridgway Foley, George Roche, F.A. Harper, Ben Rogge, and Ed Opitz, among others. The authors discuss the importance of the natural-rights philosophy for the Founding Fathers while also examining the negative influence of the 19th-century doctrine of positivism. This compilation is a useful resource for all students of history, philosophy, and freedom.

Paper, 389 pages: ~~$18.95~~ **Sale: $7.00**

Reflection and Remembrance, Hans Sennholz. Dr. Sennholz was a long-time Trustee of the Foundation as well as a regular seminar lecturer. From 1992 until 1997 he served as President of the Foundation. Dr. Sennholz is known for his knowledgeable and enthusiastic support of the Austrian School of Economics. This book collects his "Notes From FEE" columns. Grouped into six categories, these essays address first principles, education, the poverty of politics, ideas and policies, a look abroad, and the future. This anthology presents a broad overview of Dr. Sennholz's unique perspective.

Paper, 255 pages: ~~$12.95~~ **Sale: $6.00**

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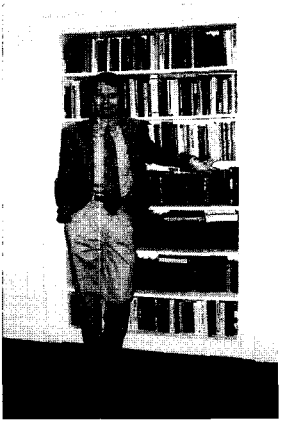

Late last year it was my privilege to announce that FEE had received a major new challenge grant from two anonymous contributors.

If FEE raises $150,000 in new money (gifts received and deposited by March 31, 1999), these supporters will give FEE an additional $100,000. Put another way, if we meet this challenge every three dollars you help us to raise will yield an additional two dollars!

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We are making progress toward our goal—and invite you to be part of this exciting effort.

Don Boudreaux

Donald J. Boudreaux
President

Contributions can be made by telephoning (800) 452-3518 and using your Visa, MasterCard, American Express, or Discover Card, or by using the reply envelope included in this issue. For those who have recently contributed, a heartfelt thanks from the entire FEE staff and Board of Trustees.

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The inflationary policy can only be effective *if governments decree that the notes be deemed legal tender*. Legal tender imposes on traders the requirement to accept the note at its face value. Therein lies the rub. If the government had to pay off a million-dollar debt but could not stomach a rise in taxation, its central bank could print the necessary legal tender bill, and the newly printed note could discharge the government's debt. Such an action costs the government nothing but the paper and ink the note is printed on, and traders cannot discount the bill except through increasing their prices.

Legal tender thus provides national governments with a covert method of raising funds without raising taxes. But once the money seeps into the foreign currency markets to pay for increased imports or to pay off debts, the currency must depreciate, for in the international arena traders mark down the value of the currency against others.

It would be otherwise for national traders if legal tender laws were abolished. Under a free tender scenario, traders would use those currencies in national and international trade that prove to be useful to them—that is, those that keep their value. Which currency traders would choose is not something that can be determined by legislation or a priori; the choice is fully in the hands of the millions of traders in millions of markets.

If legal tender laws were abolished, traders would discount government notes in local as well as international markets, which would remove from government the possibility of earning revenue from inflation (that is, paying off debts with legal-tender devalued currency). The resulting effect is the reverse of Gresham's Law, in which bad money drives out the good. Gresham's Law prevails when legal tender rules apply; however, if traders were free to choose between currencies, the good money would drive out the bad, a point noted by F.A. Hayek. Ample evidence of the Hayek-Gresham Law can be found in economic history from early American currency history to pre-Revolutionary Russia and to the more recent hyperinflations in which street traders clamor for alternative currencies such as the dollar and deutschmark.

Money Can't Be Invented

Legal tender laws effectively have nationalized currencies, making them the prerogative of the state. Economics teaches that money cannot be invented or created by decree, that it is very much the result of traders' decisions across many markets and over much time. It is time to return currency to the market.

With free choice in currency, traders would converge on the money that best suited their needs. In the last two decades economists have conjectured what forms such money could take, from electronic cash to redeemable currencies, some redeemable against a basket of goods or even a basket of futures, or against gold and silver. What is certain is that the choice is and should be the market's. No one can predict the media that present businesses would find most useful—most probably they will converge onto one medium or onto a few universally accepted media, but the definite result would be an end to the credit creation and inflationism of central banks and national governments. Central banks would most certainly lose their powers, but currencies would lose their chains. □

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THE FREEMAN
Ideas On Liberty

Small Is Awesome

by Max More

Giant corporations controlling national governments. Corporate behemoths regimenting their workers, controlling their customers, and obliterating their smaller competitors. The rich get richer and the large get larger until a small handful of megacorporations rule the planet.

We have heard this warning about King Kong capitalism from Marxists and other statists for decades. The future is always about to bring about the death of small companies and individual initiatives. Since the 1980s a new, popular form of science fiction known as "cyberpunk" has reinforced this view in the popular imagination. Books such as William Gibson's *Neuromancer* suggest that our economic system will become utterly dominated by a few faceless bureaucratic megacorporations. One of the great appeals of a free-market economy is precisely that it promises to distribute power widely. But the image of the future being pushed at us will undermine that appeal if it goes unchallenged. Ironically, the result will be a call for more intervention by the state—the most monolithic, bureaucratic institution imaginable.

Those who understand how free markets really work have long responded to these dire predictions with economic theory and history. We know that harmful monopolies have little chance of forming and surviving without government intervention, whether in the form of direct government ownership, subsidies, legal privileges, trade protection, and so on. Contemporary enemies of the market may suggest that advanced technology has changed the rules, making megacorporations and monopoly inevitable.

On the contrary, an analysis of what makes firms a certain size, combined with an understanding of technological change, reveals a far different and more exciting picture.

Over 500 million years ago, sparked by the introduction of sexual reproduction, the Cambrian Explosion brought a massive proliferation of new life forms. Multicelled organisms appeared (jellyfish, sponges, and worms) along with the first shelled creatures. As we enter the 21st century, technological changes will have a similar effect on another kind of ecosystem: the economy. Contrary to the expectation of highly concentrated corporations, we will see the proliferation of new organizational forms. The keys to success will not be overwhelming size but flexibility, agility, rapidity of response, and the ability to reform, spin off, dissolve, and recombine into new business structures. These changes are already underway.

To understand what kind of corporate environment will emerge in the markets of the next century, we need to answer two questions:

- What economic forces determine the size of firms?
- How will information technology affect those forces?

Max More is president of Extropy Institute in Marina Del Rey, California. He may be reached at more@extropy.org.

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The answer to the first question lies in economist Ronald Coase's theory of transaction costs. The answer to the second lies in the Internet and a powerful new form of business software called enterprise resource planning software.

The Size of the Firm

Why do firms exist in the first place? And why do they grow to a particular size? Ronald Coase won a Nobel prize for being the first to seriously tackle these questions. His answer involves the concept of "transaction costs." We might wonder why, for any production job, individuals do not simply make contracts with each other on the market instead of forming a firm. Why not carry out production in a completely decentralized manner rather than centralizing activity within a firm?

The problem is that negotiating and settling contracts for every exchange transaction consumes time and energy. Every time something new is to be done, contracts have to be renegotiated. These transaction costs often make it difficult and expensive to be productive. If you simply want someone to paint your garage, an individual agreement with the painter makes sense. It would be pointless to form a corporation with the painter. But if you wanted to work with the painter and 20 of his buddies to paint a variety of buildings over a long period of time, forming a corporation and hiring them as employees might make sense.

Carl Dahlman has identified several kinds of transaction costs. Search and information costs involve the difficulty in finding the right people with whom to make a contract for each task. Bargaining and decision costs involve the time and energy used to reach agreement on the terms for each task. Policing and enforcement costs involve the expense in ensuring compliance with each individual contract. When individuals form a firm, a single employment contract replaces this complex series of contracts. The contract states that the person agrees to do what the employer or entrepreneur says within certain limits in exchange for specified compensation. Direction by the entrepreneur replaces numerous contracts made in the market.

Firms will continue to grow so long as the cost of adding activities by organizing labor and resources within the firm is less than the cost of contracting for those factors on the market. The firm will stop growing at the point where the costs of organizing a transaction internally equals the cost of carrying it out through market transactions.

Firms will tend to grow under several conditions. If workers are closer together, it becomes easier to organize them. The movement of people to cities in the Industrial Revolution helped companies to get bigger. Government policy can also alter transaction costs to favor growing firms. For example, sales tax is imposed on market transactions but not on activities within the firm. The higher the sales tax the more the cost advantage to corporate organization of economic activity.

Technology and Transaction Costs

Technological change can strongly alter transaction costs and so affect the size of firms. Coase himself noted that an invention like the telephone may tend to increase the size of the firm. It does this by making it easier to organize widely dispersed individuals. Yet as Coase also noted, every invention will change not only the costs of internal organization but also the costs of using the price mechanism. Whether firms get larger or smaller depends on which effect is greater. In today's world of a rapidly evolving Internet and increasingly powerful business software, technology is already changing the optimal size of the firm and the look of the business ecosystem.

We don't need to look to the future to see the effect of technology on the size of firms. Twenty-five years ago Fortune 500 companies employed 20 percent of workers. Now it's only 10 percent. Many observers have noted that the widespread use of e-mail has flattened corporate hierarchies. These companies may be larger than ever in terms of money flows, but the number of layers of communication between top executives and lower-level operatives has shrunk. Some fast-paced technology companies actively encourage their

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employees to communicate directly with high-level planners. The popularity of software such as Lotus Notes and "groupware" is enabling groups of employees to communicate with less managerial mediation.

Two areas of technology will have the most profound impact on business organization, flattening hierarchies, enabling innovative business structures, and fostering temporary, flexible work teams in place of fixed giant corporations. These areas—computer networks and enterprise systems—work together to alter the incentives of business.

Computer networks include the rapidly growing Internet. The utility of the Internet grows as the number of computers and users on it grows and as bandwidth expands. Fax machines were not terribly useful when only a handful of people had them. Once they became almost ubiquitous, their utility improved drastically. Similarly, when only a few physicists in Switzerland used the World Wide Web, its utility was severely limited. As millions of individuals and tens of thousands of businesses go online, more and more of us find the Internet indispensable. As bandwidth improves, its utility will grow further as we move to real-time video and interactive virtual environments.

Along with the Internet, businesses are developing "intranets" and "extranets." Intranets are computer networks accessible only within the corporation. They allow the easy and efficient sharing of corporate information, tracking of activities, and communication of ideas. Extranets extend a company's networks over the Internet to its suppliers, customers, and partners. Intranets reduce transaction costs within the firm, while extranets and the Internet itself also reduce costs in the market.

Dramatic Productivity Gains

Enterprise systems add to the business transformations being wrought by computer networks. Enterprise systems take the form of enterprise resource planning (ERP) software (and related packages such as supply-chain management and sales-force automation software). When a company installs ERP software it is not simply running another piece of business software. It is installing a business model—a way of doing business embodied in the structure of the program. Enterprise systems organize and integrate a company's reporting, sales and delivery, financials, manufacturing, service, inventory and supply, and human resources. More and more businesses are installing these programs in pursuit of enormous productivity gains. A company might reduce the time it takes to re-price all its products from five days to five minutes, reduce credit checks from 20 minutes to three seconds, and ship products within 24 hours instead of two weeks.

The development and convergence of computer networks and enterprise systems are changing the shape of corporations by reducing transaction costs. Even when companies appear very large, as measured in terms of their revenues, they employ relatively few people. They are becoming increasingly "hollow." Dell Computer, for example, differs greatly from traditional manufacturers. It not only does not make computer parts, it does not even buy the low-level components. Instead it buys subsystems and assembles them into a range of computers. Since Dell does no manufacturing, it can fulfill orders rapidly. Thanks to its enterprise system, it carries an incredibly low eight days of inventory (compared to two months for competitors).

Some companies are so decentralized that they never even handle their products at any point. One fashion accessories company with $80 million in revenues has only three employees. It contracts with other companies and individuals to make its products, design its packaging, and distribute and sell its products. The automobile industry is experiencing similar changes. A modern factory will simply fit together pre-assembled parts.

Companies are not only hollowing out; they are becoming more fluid in organizational structure. I have already noted that e-mail and intranets allow employees to communicate directly and easily. Intranets also give everyone ready access to corporate information without having to go through management. As the flow of information has improved, it

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has become easier to loosen the corporate structure while continuing to track activity. Largely autonomous temporary work teams have been one result. Traditional companies maintain a strict organizational hierarchy. Each employee has a superior, and that superior has a higher level superior. Increasingly, employees are forming independent work teams with no fixed boss. Business units within corporations even deal with one another as if they were independent companies, having to make competitive offers for their services. This is sometimes called "intrapreneurship."

Hollow corporations, outsourcing, independent business units, and intrapreneurs join other trends to transform the corporate landscape. Temporary workers and free-lancers add to organizational flexibility. The temporary agency, Manpower Services, now employs more people than any other private company. As Internet access improves and bandwidth expands, telecommuting becomes an option for more and more people. As these new options proliferate, bigness often becomes less appealing. More companies spin off operations into new corporations, adding to their flexibility and focus.

Computer networks continue to spread and to expand in capacity. We find sound and video appearing all over the Web. Full motion teleconferencing is becoming feasible. Before long we will see virtual reality technology reach a point where virtual meetings can take place, making physical proximity unnecessary. Individuals will search for one another over the Net, set up businesses using off-the-shelf enterprise systems, then dissolve their team when the job is done, perhaps never having physically met at any time.

Large, stable, enduring corporations will not disappear. But they will cease to dominate the corporate ecosystem. The new face of business will look far more diverse. We will see constellations of activity, including large corporations, corporations with vast revenues but few employees or production facilities, temporary firms formed for a single project (which might be hugely complex), and semi-independent work teams. The existing large companies may perform the valuable role of creating the cultures and standards that allow these corporate mutations to emerge and flourish.

Government: Stay Out of the Way

Governments may slow down this process, but cannot stop the forces of technological change. The best way to help is to stay out of the way as new business structures form. They can also help by cutting sales taxes. Sales tax is paid on exchanges between companies but not within a company. This makes it more economic to organize activity internally rather than contracting for it on the market, making companies bigger.

We will not become citizens of Microsoft or General Electric. While large corporations will probably continue to exist in the future, they will not dominate the economy. On the contrary, the continuing reduction in transaction costs, the expansion in computer network bandwidth, and the ability to quickly create a business using off-the-shelf processes will accelerate today's trends toward a more diverse and flexible business environment. Free markets will bring not King Kong capitalism but a network of dynamically changing organizations. Permanent corporations will be only one of many species in the business ecology of the 21st century.

The market is vastly smarter than any individual, so we cannot predict exact or complete details of the emerging economy. Yet the trend clearly favors flexibility over rigidity, responsiveness over resistance, and speed over size. □

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Economics

Captain Consumer

> "The direction of all economic affairs is in the market society a task of entrepreneurs. Theirs is the control of production. They are at the helm and steer the ship. A superficial observer would believe that they are supreme. But they are not. They are bound to obey unconditionally the captain's orders. The captain is the consumer."
>
> —LUDWIG VON MISES, *Human Action*

Every day the business pages of the newspaper affirm Mises's claim about consumer supremacy. Within a three-week span last fall, the *Washington Post* reported:

> Toys R Us to Close 90 Stores
> Retailer Announces Restructuring,
> Charge Against Earnings
>
> Boston Chicken Files for Protection,
> Lays Off 500, Shuts 178 Restaurants

For years, Toys R Us has been the largest toy retailer in the United States, with 25 percent of the market. Yet in September it announced it would close 90 of its 900 stores in the United States and elsewhere around the world and redesign the rest. Boston Chicken (which calls its restaurants Boston Market) said in October it would close 178 of its 1,143 outlets, lay off 500 employees, and reorganize under the bankruptcy laws. It was once a hot stock, as patrons found the rotisserie chickens and other dishes attractive dining alternatives. But from a high of almost $40 in late 1996, the company's stock closed at 50 cents a share when the bankruptcy was announced.

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What happened to these once-booming companies? Captain Consumer found something he liked better.

Parents came to feel the Toys R Us stores were poorly organized and unfriendly; kids' taste in toys shifted to high-technology, and the chain was slow to notice. Hungry folks decided that, rather than stop at Boston Market for dinner, it was more convenient to buy rotisserie chickens and other ready-to-eat meals at the supermarket.

People changed their minds. Without notice and without asking anyone's permission, they abandoned Toys R Us and Boston Market and took their money elsewhere. (Try that with the public school or post office.)

Mises had it right: consumers "are merciless bosses, full of whims and fancies, changeable and unpredictable. . . . If something is offered to them that they like better or that is cheaper, they desert their old purveyors. In their capacity as buyers and consumers they are hard-hearted and callous, without consideration for other people."

Critics of the free market focus their animosity almost exclusively on the businessman. He is the boss. He decides what to produce and what to charge for his goods. He

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decides who is hired and at what wage. As Mises notes, it does look that way. Appearances, however, are deceiving.

Entrepreneurs at one level drive the market process. But in an important sense, they don't act independently. They try to anticipate what Captain Consumer will want. He doesn't always know what he will want tomorrow because he doesn't know all that there *is* to want. No one wanted a personal computer before the idea was thought up. But a few entrepreneurs bet that people *would* want PCs when they learned of their existence. In that case, the businessmen were right. With the Edsel and countless other things, businessmen were wrong. Those who anticipate correctly make money; those who don't, lose it. Bankruptcy is the consumers' way of telling a businessman they would prefer that his capital were in more capable hands.

"Their buying and their abstention from buying decides who should own and run the plants and the farms," Mises wrote. "They make poor people rich and rich people poor. They determine what should be produced, in what quality, and in what quantities."

In terms of law, particular individuals own the means of production. But in economic terms, they hold their property only at the pleasure of consumers. "Thus the owners of the material factors of production and the entrepreneurs are virtually mandataries or trustees of the consumers, revocably appointed by an election daily repeated," Mises said.

The point applies as well to the businessman's employees. He may write the paychecks, but "The consumers, not the entrepreneurs, pay ultimately the wages earned by every worker, the glamorous movie star as well as the charwoman," Mises wrote.

That's the answer to the market's critics, who can't understand why Jim Carrey or Mark McGwire command such high salaries, while people in "more important" occupations are paid much less. When fans stop going to Carrey's movies or McGwire's ball games, those salaries will fall. The same is true for the "obscenely" large paychecks that corporate executives collect. If consumers reject a corporation's products, its executives will see their incomes shrink.

Unless the government intervenes. The market's critics will point to notorious cases of highly paid executives who run inefficient companies. Blame the mixed economy. That term is a euphemism for a market-based society in which government routinely countermands Captain Consumer. When the government bailed out Chrysler, permitting Lee Iacocca and his managers to remain in charge, politicians forced people to do as taxpayers what they had refused to do as consumers. (The bailout consisted of taxpayer-backed loan guarantees. Diversion of capital to Chrysler of course left less for projects consumers would have embraced.)

Government has more subtle ways to keep consumers from carrying out their will. In a free market, if they are unhappy with a corporation's products, investors will anticipate low or no profits in the future. That will translate into a lower stock price. Noticing the squandered potential, an entrepreneur specializing in takeovers might buy the stock (undervalued in terms of the profit potential), put in better managers, and reap the benefits of a later rise in the stock price. This process is what economist Henry Manne calls the market for corporate management. It protects consumers and stockholders. Of course, it also threatens the jobs of bad managers, which is why the takeovers are called "hostile."

How might the government, backed by incumbent managers, interfere with the market for corporate management? It can enact measures to impede takeovers. The federal Williams Act, for example, makes it illegal for entrepreneurs quietly or anonymously to buy up controlling shares of a company's stock. Under cover of "full disclosure" and "investor confidence," the Act requires that entrepreneurs show their hands early. That of course gives targeted managers time to defend their jobs. Disclosure also tends to push stock prices higher, spoiling many takeover plans.

Ironically, the same market critics who believe that businessmen rule consumers also favor anti-takeover laws, which shelter businessmen from the same consumers.

Maybe it's not so ironic. Maybe the market's critics think someone else should be captain. □

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THE FREEMAN
Ideas On Liberty

A Program the Borg Would Love

by Karen Selick

ONTARIO, CANADA—Suppose you're out for a stroll one evening. A scruffy-looking stranger approaches you and says, "Hand over all your valuables, and make it snappy." "Is this a stickup?" you gasp, stupidly.

"Why, no," says the stranger, "it's merely the result of a cost-benefit analysis I just performed. I saw you come out of that nice-looking house over there, with the late-model car in the driveway. You're pretty well dressed, and that's a nice Rolex you're wearing. By comparison, the rent's overdue on my grungy apartment, my 12-year-old car needs its engine overhauled, my bank account's overdrawn, and just look at these worn-out clothes I'm wearing. I estimate that the benefit to me of having your valuables outweighs the cost to you of losing them by at least two to one. So hand them over."

If the robber's logic wins any points with you, then I've got a new government program to sell you. It's called national child care. Of course, it's not really new, but with all the recent talk about the "fiscal dividend," we can expect to see renewed hoopla over it in coming months.

An opening salvo was fired in March 1998 with the publication of a study titled "The Benefits and Costs of Good Child Care" by the University of Toronto's Centre for Urban and Community Studies. This study made national headlines in Canada because of its dazzling cost-benefit analysis. An expenditure of $5.3 billion on child care, it said, would generate benefits to children and parents of $10.6 billion—exactly double. Such a program should therefore be looked upon not as an expense, but rather as an "investment."

Misuse of Cost-Benefit Analysis

Unfortunately, the authors of the study make the same fundamental error as my fictitious robber. A cost-benefit analysis makes sense only when the costs are incurred and the benefits are received by the same person. If costs are inflicted on one person while benefits are reaped by someone else, it is simply impossible to say whether the world has been made a better place. For the person receiving the benefits, things have improved. For the person bearing the costs, things have deteriorated. But there is no way to measure the absolute quantity of either person's happiness. Individuals can rank their preferences (having more money usually ranks higher than having less), but they can't quantify them. There are no units of satisfaction or contentment. Using dollars as proxy measuring sticks doesn't help, because each additional dollar a person acquires adds less to his well-being than the previous dollars. You can't measure something when the measuring stick itself continually alters in size.

If you can't measure one person's quantity of happiness, it's even more obvious that

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you can't compare quantities of happiness between different people.

Economists have recognized these concepts for years, yet some people insist on fudging the issue by speaking of costs and benefits to "society," as if we were the Borg of *Star Trek* fame, all controlled by a single communal brain, all willingly subordinating our individual personalities and goals to the will of the collective. We aren't—at least, not yet. (One can't help wondering, however, whether the push toward government control of the country's children at ever younger ages reflects proponents' desire to achieve a state of Borg-like submissiveness.)

The fact is, some people would be net beneficiaries of national child care—primarily families with young children in which both parents wish to work outside the home. Other people would be net payers—namely, childless taxpayers, families with older children, and families that prefer to have one parent provide care to preschoolers at home. There is no fair, just, or moral case to be made for harming the second group in order to indulge the first.

The Unseen Neglected

The study contains a second fundamental flaw. In computing the cost side of the balance sheet, the authors fail to include any estimate of the advantages that would accrue if the same $5.3 billion were spent on something other than child care. Somewhere out there, toiling away in some laboratory, there is undoubtedly someone who could make a plausible case for "investing" $5.3 billion on his own pet project—perhaps a cold fusion machine. If he were successful in inventing such a device, the benefits to mankind would be incalculable—far more than the paltry $10.6 billion that child care would supposedly produce.

There are always competing uses for any resource. In deciding how to invest resources, you don't look just at the potential returns from a single alternative. You compare the expected returns from many different alternatives.

We don't know what alternative uses taxpayers would find for their money if we simply gave it back and let them invest it themselves, instead of spending it collectively. We can't calculate the benefits their myriad individual projects would generate. We do know, however, that taxpayers would probably prefer this to all other alternatives. Otherwise, we wouldn't have to force them to pay their taxes on pain of imprisonment.

There are many other good reasons for opposing national child care. Suffice it to say that if it's going to be as effectual as the public school system, let's nip it in the bud. □

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THE FREEMAN
Ideas On Liberty

Wisconsin's Choice

by Jon Sanders

The plaque is proudly posted at the front entrance to Bascom Hall on the campus of the University of Wisconsin at Madison. It memorializes the eloquent defense of academic freedom made by the university's Board of Regents in 1894 in exonerating Richard T. Ely, an economics professor accused of teaching socialism and other "dangerous" ideas.

"Whatever may be the limitations which trammel inquiry elsewhere," the plaque proclaims, "we believe the great University of Wisconsin should encourage that continual and fearless sifting and winnowing by which alone the truth can be found."

Donna Shalala walked by that plaque countless times when she served as the university's chancellor from 1988 to 1993, the year she became Bill Clinton's secretary of Health and Human Services. But she paid no attention to it. Her ideal campus of sensitive minds had no place for the plaque's dangerous idea.

Under Shalala's administration, and counter to the school's heritage, Wisconsin suffered severe limitations on inquiry in the form of speech codes for faculty members and students. The student speech code that went into effect in 1989 was one of the first standards on "hate speech" in the nation. It prohibited students from uttering slurs or epithets based on a person's race, gender, sexual orientation, religion, disability, or ethnicity. In 1991 a federal judge struck it down as unconstitutional. The faculty speech code, however, has faced no such court challenge.

The speech codes were part of several politically correct campus initiatives designed to make minority students feel more welcome on campus. Other initiatives included requiring students to take ethnic-studies courses, designing orientation programs to increase awareness of racial and ethnic diversity, setting enrollment goals for black, Hispanic, and American Indian students, and urging that the ROTC program be banned from campus until the military stopped discriminating against homosexuals.

Speech Further Restricted

Wisconsin's faculty speech code was originally established in 1981, but Shalala considered it insufficient to protect minorities from being offended in the classrooms. She asked the faculty senate to pass a revised code that further restricted faculty speech, which it did in 1989.

The enhanced code has trammeled speech in Wisconsin's classrooms for nearly a decade. It forbids faculty members from slurring students according to their gender, race, ethnicity, and so on, but it also punishes the use of teaching techniques that make "the instructional setting hostile or intimidating, or demeaning" to students according to their "group." If a professor invokes a theory in

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class that offends a particular group, he violates the code, probably without even realizing it. Under the code, however, the offense is in being offensive—whether intended or not.

Wisconsin's revised faculty speech code quickly became a wellspring of consternation for the teachers. Although no faculty members were ever formally investigated and disciplined for violating the code, several underwent grueling informal investigations for alleged violations about which they were told very little. The Kafkaesque investigations made it patently clear on campus that Wisconsin tolerated no breach, however slight, of the PC ethic.

In 1990, Richard Long, an art professor, was investigated by the Affirmative Action Office after two graduate students accused him of being anti-Semitic, racist, sexist, and homophobic. Although formal charges were never brought and he was never officially informed of his situation, Long underwent a six-month investigation before the matter was dropped for lack of evidence. "I never received anything resembling due process," he wrote in 1995 in a letter to the *Wisconsin State Journal*.

In 1992 Lester Hunt, a philosophy professor, was investigated after a student accused him of making racist jokes and comments. Like Long, Hunt was neither told of the charges against him nor given an opportunity to confront his accuser. "I would not want my worst enemy to go through what I went through," he told *The Daily Cardinal*, Wisconsin's online student newspaper.

In 1995, Robert Eric Frykenberg, a history professor, was accused of making disparaging comments to female graduate students. During the nine-month investigation, Frykenberg was never told which university rule he had allegedly violated. Finally, after he retained a lawyer and threatened to sue the university, the investigation was dropped and the university agreed to pay his legal bill. Frykenberg retired not long afterward.

Other teachers, understandably unwilling to risk the problems faced by their colleagues, voluntarily excised from their lectures anything that could be construed as offensive. The fierceness in investigating supposed violators frightened them, which was exactly the intent behind the code, said Stanley G. Payne, a professor of history at Wisconsin. "This helps to guarantee that no one will very seriously question any P.C. proposition," he told *The Chronicle of Higher Education*. "[The code] doesn't need to be invoked to police discussion in the classroom."

By this declension, "fearless sifting and winnowing" on the Madison campus became fearful shifting and whimpering. The code turned the faculty lounge into a Damocletian feast.

The Last Straw

The Frykenberg case, however, proved to be the final straw for some Wisconsin professors. In 1996 Payne formed the Faculty Committee on Academic Freedom and Rights (FCAFR). Well-known academics were brought to campus to denounce the code. In 1996, for example, Harvard University Law Professor Alan Dershowitz, known to many Americans for serving on the team of attorneys who defended O.J. Simpson, called the faculty speech code "abominable" and urged the capacity crowd in attendance to defeat it, saying the university would make national headlines by repealing it without being forced to do so by the courts. In 1997 Professor Glen C. Loury of Boston University argued that any legislation restricting speech is wrong. "Our job as faculty members is to be provocative and challenging," Loury told the Wisconsin crowd. "You're not there to make students comfortable, you're there to break through conventional ways of thinking."

Meanwhile, Hunt and FCAFR member Donald A. Downs, a professor of political science, shamed the University Committee into taking another look at the code, charging that it infringed free speech and academic freedom. The charge struck at the heart of the matter, pitting Shalala's legacy against the university's. In May 1997 the University Committee formed a panel of ten faculty members, four academic staff members, and three students to investigate the code.

The panel, the Ad Hoc Committee on Prohibited Harassment Legislation, was as congenial as a coalition of Middle East coun-

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tries. Among the members who favored the Shalala code were Ted Finman, an emeritus professor of law who wrote the original speech code; Evelyn Howell, a professor of landscape architecture who had served as chairman of the University Committee when it selected the panel members; Phillip R. Certain, dean of the College of Letters and Science; and Stanlie M. James, an associate professor of Afro-American and women's studies. Among those seeking to overturn the code were Downs, journalism professor Robert E. Drechsel (the panel chairman), and the three student members.

Early last October, the so-called liberals on the panel succeeded in getting enough of their conservative counterparts to agree to send a compromise revision of the code, which would scale back the Shalala revisions, to the faculty senate. The new revision would penalize professors who use "an epithet or a comment concerning a specific student that clearly derogates and debases the student on the basis of the student's gender, race, religion, ethnicity, sexual orientation, or disability" or who utter such comments without "a reasonable pedagogical justification for using the teaching technique in question."

The revision would add a preamble discussing the university's legacy of academic freedom and include examples of teaching techniques that would and would not be protected. Protected speech would include an instructor's assigning a "pertinent novel that expresses racist ideas or contains a racial epithet" or asserting that "the intellectual capacity of men for scientific analysis is superior to that of women." Prohibited speech would include an instructor's referring to Africans transported to the United States in slave trades as "niggers" or responding to a female student's rebuttal of his assertion of women's inferior scientific intelligence with "See! Your stupid female comments just prove my point." The faculty senate recommended adoption of the revision late last year.

The faculty senate also received a report from a stubborn minority comprising Downs, Drechsel, all three student members, and two others on the committee. That report would narrow the speech code further than the majority recommendation, penalizing professors only for using slurs expressly for the purpose of harming a student.

A split in such a committee is unusual, and it has set the stage for a potentially raucous faculty senate meeting. It is fitting that the fight end there. The issue is essentially whose idea of academic freedom will rule, Shalala's or the 1894 regents'. *Essentially*, but not exactly. The compromise revision, which likely will be adopted, represents only a step back from the PC precipice to which Shalala brought the university. The minority report recommends a narrower speech code, but as the student editorial staff of *The Daily Cardinal* opined, "The committee must understand that any new speech code—no matter how well written—is still a speech code." Neither allows inquiry as open as it was before 1981.

As that statement shows, it is the students, the supposed beneficiaries of the code, who are most vociferous in trying to end it. More so than the faculty and administration, they seem to understand the importance of free, even offensive speech. In fact, they appear to be less insulted by ill-advised faculty speech than by the idea that such speech would harm them. "Are they saying I can't stand up for myself?" asked one student on the panel, Amy Kasper, in *The Chronicle of Higher Education*. "Am I being wrapped in a security blanket here, and I'll go out in the real world and find there isn't one?"

The student panel members should be of particular interest to those of the PC mindset. They are a white woman, an Asian woman, and a gay man. All consider the code—and the attitude behind it—"demeaning." For unlike the Wisconsin teacher who argued that the code is needed so students "don't get insulted or assaulted by a professor," Wisconsin students of all stripes know that words, even those uttered by professors, are neither sticks nor stones. □

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Economics

The Market for Honesty

The recurring theme of all my columns has been that economics is a study of how people cooperate with each other and that market economies succeed because of the incredible amount of cooperation they promote. Market cooperation, like all cooperation, depends on a high level of honesty. People who cannot trust each other cannot cooperate with each other, certainly not for long. And with the market, it's not just a matter of trusting a few people whom we know and care about. Market cooperation depends on our being able to trust large numbers of people, most of whom we will never know.

Consider the behavior of business people. If the proverbial man from Mars observed our business activity, he would surely conclude that business people are extraordinarily honest. For example, they sell precious gems that really are precious to customers who cannot tell the difference between diamonds and cut glass. They promise not to raise the price of a product once customers commit themselves and make switching to another product costly—and they keep the promise. They make good-faith promises that the business they own, but are about to sell, will continue to give their customers good service. The examples could be continued indefinitely since honesty and trust are essential for all but the simplest business transactions.

I am not naïve enough to argue that business people are never dishonest. Just like people in all walks of life, some will cheat, lie, and steal to snatch short-run advantage. But they are not nearly the scoundrels as presented in the media and popular entertainment. According to one study, almost 90 percent of all business characters on television are portrayed as corrupt.[1] In fact, business people can be depended on to act more honestly than most. This is not because business people are inherently more virtuous than others (though there is no reason to believe they are less virtuous), but because the free market penalizes those who do not provide consumers with things they value—and consumers value honesty.

The reason the market penalizes dishonesty is obvious at one level. Those who fail to provide the quality they promise, and charge for, may profit in the short run, but not in the long run. But even in the short run there are gains from honest dealing, and those who can credibly promise to deal honestly can capture some of those gains. So business people are strongly motivated to put themselves in situations in which dishonest behavior is quickly penalized. By doing so they are better able to entice customers with assurance of everyday honest dealing.

Committing to Continuity

Consider the fear of dishonesty that can arise when it is believed that a business is about to shut down, say, because the proprietor is getting old. Even if such a proprietor has no intention of cheating customers, they

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will have reason to worry without some credible assurance of the proprietor's long-run interest in the business. An owner can often provide this assurance by bringing his offspring into the business ("Samson and Sons" or "Delilah and Daughters"). Not surprisingly, research shows that children of single proprietors are three times more likely to follow in their parents' lines of work than the children of others. Even large corporations, with lives that extend far beyond those of any of their managers, often depend on single proprietorships to represent and sell their products. This explains why Caterpillar, for example, has a school on running Caterpillar dealerships for the sons and daughters of the owners of those dealerships.

To consider another example of the importance of business continuity in promoting honesty, ask yourself where you would rather shop for an expensive piece of jewelry, a jewelry store with a well-advertised brand name and ornate fixtures, or a sidewalk vendor operating out of a Volkswagen van parked at the curb? What could the store do with its brand name and fixtures if it went out of business? Not much, and this tells customers that the store has a lot to lose by misrepresenting its merchandise to capture short-run profits. It has made a commitment to staying in business by being honest.

Embracing Competition

Intel, having received a patent on its 286 microprocessor in the early 1980s, immediately gave up its monopoly by licensing a competitive firm to also sell the microprocessor. Why would any company give up a legal monopoly? Because of the importance of honesty. Intel was willing to sell its new microprocessor to computer manufacturers at a reasonable price, and promised to do so. But the manufacturers were afraid that once they committed to using the new microprocessor (making expensive changes in their production process that would be difficult to reverse), Intel could exploit its long-term patent monopoly by raising the price. Intel could make a credible promise that it would maintain competitive prices by giving up its monopoly. Committing itself to honest dealing was more important to Intel, and more profitable in the long run, than exploiting a monopoly position in the short run.[2]

Selling and Repairing

It is difficult for consumers to determine the quality of automobile repair. They can generally tell if the work eliminated the problem: the car starts, the rattle is gone, the oil light is off, and so on. But few people know if the repair shop charged them for only the repairs necessary, or if it charged them for lots of parts and hours of labor when all the mechanic did was tighten a screw. One way repair shops can reduce the payoff from dishonest repair charges is through joint ownership with the dealership selling the cars being repaired. In this way the dealer makes future car sales largely dependent on honest repair work. Dealerships depend on repeat sales from satisfied customers, and an important factor in how satisfied people are with their car is the cost of upkeep and repairs. The gains a dealership could realize from overcharging for repair work would be quickly offset by reductions in car sales.

Automobiles are not the only product for which it is common to find repairs and sales tied together in ways that provide incentives for honest dealing. Many products come with guarantees and warranties entitling the buyer to repairs and replacement of defective parts for a specified period. These guarantees provide confidence in the seller's honesty when advertising the quality of his product.

Some will always go for the short-run gain through deceit and dishonesty. But the greater the freedom of others to compete with credible commitments to honesty, the less dishonesty pays even in the short run. The cooperation that characterizes the free market would never be possible without the high level of honesty and trust motivated by market competition. □

1. See Robert Lichter, Linda Lichter, and Stanley Rothman, *Watching America* (New York: Prentice Hall, 1990), p. 146.
2. Adam M. Brandenburger and Barry J. Nalebuff, *Co-opetition* (New York: Currency/Doubleday, 1996), pp. 105–106.

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THE FREEMAN
Ideas On Liberty

The Life of a Grand Old Liberal

by Wendy McElroy

Moses Harman (1830–1910) is the sort of social visionary whom historians often overlook, even though his influence during his own lifetime was immense. Harman lived most of his life in the American midwest, sharing many of the values that are associated with the region: he was a soft-spoken, hard-working, and devoted family man with an unswerving sense of right and wrong.

He was also one of the most stubborn and persistent nineteenth-century Americans involved in the fight to preserve individual rights. Most of his writing remains buried in the pages of the now obscure periodical he edited for 24 years. His main impact derives from his decades-long fight for freedom of speech, which resulted in numerous imprisonments and culminated in his breaking rocks at Joliet (Illinois) prison at the age of 75.

George Bernard Shaw referred to Harman's last imprisonment in a letter to the *New York Times* (September 26, 1905), in which he explained why he would not visit the United States: "The reason I do not go to America is that I am afraid of being . . . imprisoned like Mr. Moses Harman. . . . If the brigands can, without any remonstrance from public opinion, seize a man of Mr. Harman's advanced age, and imprison him for a year under conditions which amount to an indirect attempt to kill him, simply because he shares the opinion expressed in my *Man and Superman* that 'marriage is the most licentious of human institutions,' what chance should I have of escaping?"

Harman and Shaw shared the same opinion of nineteenth-century traditional marriage: it was defined by laws and customs that enslaved women, who were stripped thereby of the right to their own wages, custody of their children, and the ability to defend themselves against physical or sexual attack by their husbands. As a personal matter, Harman believed in monogamy and conducted his life without scandal. But as a point of social theory and practice he insisted that "true marriage" must be an equal union between consenting adults in which the state had no rightful place. It was his insistence on speaking out for true marriage and the rights of women that led to Harman's many years of legal persecution under the Comstock Act, which forbade the circulation through the mail of information on "obscene" matters such as birth control or marriage reform.

With the streak of stubbornness that often arises in the American personality, Harman persisted in speaking out because, as he phrased it, "I believe in Freedom—equal freedom. I want no freedom for myself that all others may not equally enjoy. . . . The Spencerian formula: 'each has the right to do as he pleases, so long as he does not invade the equal right of others,' tells what freedom means. It is equivalent to saying that liberty, wedded to responsibility for one's acts, is the

Wendy McElroy, a Freeman *contributing editor, is author of* The Reasonable Woman: A Guide to Intellectual Survival *(Prometheus Books, 1998).*

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true and only basis of good character, or of morality." He wished to offer women equal freedom with men to control their bodies and their property, especially within the context of a true marriage. It was part of his lifelong battle to secure what he called the right of private judgment in moral matters.

Little Formal Schooling

Born in western Virginia to a poor family, Moses Harman grew up in southern Missouri. Although he had only a few months of formal schooling, the young Moses became an avid reader, especially after an accident left him crippled. At 16 he began teaching school and then went on to attend Arcadia College, in Missouri; the education came at great financial sacrifice to his family. Harman soon became galvanized by the ideal of abolitionism—the pre-Civil War movement that demanded an immediate cessation to slavery on the grounds that every human being had a right to his own body. When the Civil War erupted, Harman was unable to enlist in the Union army owing to his lameness. But he remained such an outspoken abolitionist that the pro-slavery county of Crawford, Missouri, once voted to run him out because of his unpopular sentiments.

When Harman married Susan Scheuck, the daughter of a Union sympathizer who had been executed by a roving band of Confederates, their marriage was a harbinger of his later commitments. Although the ceremony was conducted according to law, the young couple also entered into a personal contract that based their voluntary union on love, not duty. Their two children, George and Lillian, were both born in Missouri. A third child died with Susan during birth in 1877. One can only speculate on how deeply watching the death of his much-loved wife in childbirth influenced Harman's later insistence on the availability of birth control information to women.

In 1879, Harman took his young children to live in Valley Falls, Kansas, where his cousin Noah was a well-to-do farmer. Moses took a job teaching at the district school, and soon became known for speaking his mind in a dignified but blunt manner. One exchange in particular would determine much of his future course.

Harman became involved in the Valley Falls Liberal League, a local branch of the National Liberal League, which sought to separate church and state. This was an issue around which many figures in the American individualist tradition gathered after the Civil War. In the words of Harman, the local "club was the successor of an older club . . . which meetings were conducted on the plan of equal rights for all, regardless of race, color, party or creed." The League soon became involved in an exchange conducted with clergymen in the local Republican paper on "issues dividing the current and popular theologies from the deductions of modern science." Although respectful of Christianity, Harman argued the scientific point of view under the pseudonym "Rustic."

When the newspaper proved unwilling to continue the voluminous debate, the Liberal League issued its own periodical, the *Valley Falls Liberal* in August 1880, with Harman serving as one of the unofficial editors. It became the foremost voice in Kansas of liberalism in the nineteenth-century sense of individualism in active opposition to state interference. In 1881, it was rechristened the *Kansas Liberal,* and Harman shared editorship with Annie L. Diggs, a well-known populist. After a dispute about prohibition, which the teetotaling Harman opposed in the belief that temperance must be voluntary, he assumed sole control.

The *Kansas Liberal* would eventually be renamed *Lucifer, the Light Bearer* (1883–1907) for which Harman would soon become notorious nationwide. The name was unfortunate because it raised the worst suspicions within and created an emotional backlash among many religious-minded people. Indeed, since periodicals as controversial as *Lucifer* were able to publish without facing the legal problems that constantly confronted Harman, it is probable that at least some of his subsequent persecution was sparked by the provocative title. Harman had chosen it innocently. He wrote, "Lucifer, the ancient name of the Morning Star, now called Venus, seems to us unsurpassed as a cognomen for a journal

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whose mission is to bring light to the dwellers in darkness." When more cautious minds advised against the name, Harman characteristically dug in his heels and continued to maintain that "words are not deeds" and that neither the state nor society could rightfully restrict the words he chose.

The Censor's Watchful Eye

If the kindly and cultured Harman had been the only one to choose the words printed in *Lucifer*, his policy might have proven harmless. For better or worse, however, Harman permitted his contributors to write what they pleased. He believed that absolute freedom of speech cleansed society by allowing individuals to feel honestly drawn or repelled by certain ideas, and to understand their reactions rather than suppress them. *Lucifer* was not salacious, but merely blunt in its social and political discussions. For censors of the day, this was enough.

In June 1886, *Lucifer* published a letter from W.G. Markland, which described an especially brutal instance of forced sex within marriage and called it rape. Indeed, it may have been the first discussion in print of this subject on the American scene. The letter was graphic, but used no words that were not to be found in a dictionary or a medical textbook.

In sending the issue of *Lucifer* containing the letter through the mails, Harman ran afoul of the Comstock Act, which provided a penalty of up to ten years' imprisonment for anyone who intentionally mailed or received obscene material. Ominously, the word "obscene" had not been defined by the Act. But Anthony Comstock, its author in 1873 and organizer of the New York Society for the Suppression of Vice, defined "obscenity" to include the discussion of and protest against rape within marriage. Under the Act, the Post Office assumed the power to destroy mail arbitrarily without either reimbursing the sender or providing due process.

There is a sense in which *Lucifer* was an unlikely target for Comstock: it seemed to be an idyllic family business, a labor of love. Harman described the set-up: "I did the office work, assisted by my son George, aged fifteen, and daughter Lillian, aged thirteen who had already learned to set type. We lived on a little fruit farm one mile from the printery at which the typesetting and press work were done. Editorial work was mainly done at home, in the early morning hours and late at night, while much of the day was spent by all three at work on the farm, raising fruits and vegetables, from the sale of which we supplied our own daily wants, besides helping to defray the expenses of publication; the folding and wrapping of the paper being done at night by the entire family, including wife Isabella, whom I had married since our removal to Kansas."

This contented picture was shattered in February 1887, when a warrant was served for the arrest of the editors and publishers of *Lucifer*: Moses Harman, Edwin C. Walker, and George Harman. Harman and his son were taken to Topeka where, on executing bonds of $500 each to appear at the April term of court, they were allowed to go home. (Walker, and his 16-year-old wife, Lillian Harman, were already in jail for their non-state marriage, which Moses called an "autonomistic marriage.")

The Legal Persecution of Moses Harman

After attending the April term court, Moses and George Harman were ordered to execute another bond and to reappear the following July. At the July term, they were told the weather was too hot to present the charges against them to the grand jury. They executed another bond to appear at the October term and went home. Over the next eight years, Harman was forced to waste large portions of time traveling back and forth to Topeka at the legal whim of the court and to spend scarce money in executing dozens of bonds, even though one bond alone would have answered the requirements of law.

Finally, in October, the accused learned the nature of the charges brought against them. The grand jury indicted *Lucifer* on 270 counts of obscenity, which were eventually quashed because neither the judge nor the district

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attorney could discern a legally intelligible charge in any one of the counts. Not to be thwarted, the district attorney procured a new set of indictments, totaling 216 counts in all. The indictment was based on four newspaper articles, though charges were withdrawn on two of them. The articles included the Markland letter and a letter to the editor written by Celia B. Whitehead, a well-respected mainstream reformer. Ironically, Whitehead's letter argued *against* the birth control that Comstock considered obscene.

As a consequence of their withdrawing from the management of *Lucifer*, charges were dropped against George Harman and Walker in 1888. Moses Harman stood alone as the sole defendant. He was a defiant one. In the June 22, 1888, issue of *Lucifer*, he reprinted the Markland letter—along side the 38th chapter of Genesis, to demonstrate that the language of the letter was no more offensive than that of the Bible.

Meanwhile, Harman's ordeal stirred up a storm of protest. As a result of the controversy, the district attorney continued the case until 1890, when he would no longer be in office.

In February 1890, Harman was arrested on fresh charges arising from a letter written by a New York physician, known as the O'Neill letter. Graphic in its language and speaking from 19 years' experience in the medical practice, Richard V. O'Neill testified that he had seen many cases of the derangement or early death of women caused by "rape within marriage," similar to what had been described in the Markland letter. For publishing the O'Neill letter, Harman was escorted to Topeka once more, then released on bail of $1,000.

In May 1890, Harman was finally tried and sentenced to five years' imprisonment and a $300 fine for mailing the Markland Letter. The following August he was released by virtue of a writ of error, but a new bond was required. In January 1891, Harman was sentenced to one year's imprisonment for the O'Neill letter. Another writ of error and another bond ensued in March. The legal harassment continued for years, until in June 1895 a new sentence was passed under which Harman was lodged in the Kansas state prison at Lansing. On release in 1896, the exhausted editor moved his family and *Lucifer* to Chicago.

Of this period, he later wrote, "[F]or more than nine years, I was never for one moment free from the 'shadow of the jail'—that is, I was either securely locked within prison walls or was under bonds outside of those walls, with the threat of imprisonment, like the sword of Damocles, constantly hanging over my head." He continued by proudly declaring, "Meantime Lucifer, the real object of the prosecutors, did not die; Lucifer did not suspend; Lucifer did not retract; Lucifer, 'Son of the Morning,' did not cease to shine on friend and foe alike."

The Final Imprisonment

From battling the Comstock laws, Moses Harman had acquired the aura of a folk hero, which extended into mainstream periodicals. But the move to Chicago did not prevent the same sort of legal problems that had arisen in Topeka. Postal harassment preceded Harman's final arrest, with *Lucifer* being denied the use of second-class mail rates until the matter was appealed to Washington. Then the Chicago post office began to confiscate and destroy certain issues it declared to be obscene. One issue was destroyed because it contained an article by the venerated feminist Alice Stone Blackwell that had been reprinted from the *Woman's Journal*. Another article declared obscene by the postal authorities was an excerpt from a United States Bureau of Animal Industry report that had been issued by authority of Congress.

Finally, Harman was indicted and tried in May 1905 for mailing two articles: "The Fatherhood Question" (written by an author identified only as T.V.A.), arguing in an inoffensive manner that every prospective mother had the right "to select the best possible conditions for" procreation, and "More Thoughts on Sexology" by Sara Crist Campbell, who was nearly 70 years old, arguing that sexual ignorance inflicted needless pain on women. The court refused to allow testimony about Harman's medical condition, and the judge's instructions to the jury left little doubt as to his opinion that the articles were legally

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obscene. Thus, at the age of 75, Moses Harman was sentenced to one year at hard labor.

From Cook County jail in Chicago, Harman wrote a "hail and farewell" letter to his friends, restating the object of *Lucifer*'s publication: "to help woman to break the chains that for ages have bound her to the rack of man-made law, spiritual, economic, industrial, social and especially sexual, believing that until woman is roused to a sense of her own responsibility on all lines of human endeavor, and especially on lines of her special field, that of reproduction of the race, there will be little if any real advancement toward a higher and truer civilization."

At Joliet, where he broke rocks during the bitter winter months, Harman's health deteriorated disastrously. A transfer to Leavenworth—secured by the determined intervention of family and friends—probably saved his life. There, he spent a large portion of his remaining sentence in the hospital.

On release in 1907, the 76-year-old Harman changed *Lucifer*'s name to the *American Journal of Eugenics*. The format became more scholarly, and the focus shifted more firmly to improving reproduction and the human race, a subject that captivated many early twentieth-century reformers. The eugenic theories of Harman and similar individualist radicals were based largely on the work of such popular scientists as Francis Galton (coiner of the word "eugenics"), who believed the human race could be improved through heredity. For Harman, the main barrier to proper reproduction was the state. He believed its oppressive marriage, divorce, and anti-birth control laws almost ensured that poverty-stricken women would give birth to ill-nourished, sickly children. In calling for removal of the state from reproduction, rather than stricter regulation, the American individualists were a unique voice for individual freedom within a movement that tended toward state control.

On January 30, 1910, Moses Harman died in Los Angeles, where he had moved in 1908. *The American Journal of Eugenics* died with him. Although two memorial services were held for the venerated editor—one in Los Angeles, the other in New York City—the most fitting memorial may well have been a letter written to *Lucifer* by Lizzie Holmes almost 20 years earlier. She called Harman's periodical "the mouthpiece, almost the only mouthpiece in the world, of every poor, suffering, defrauded, subjugated woman." □

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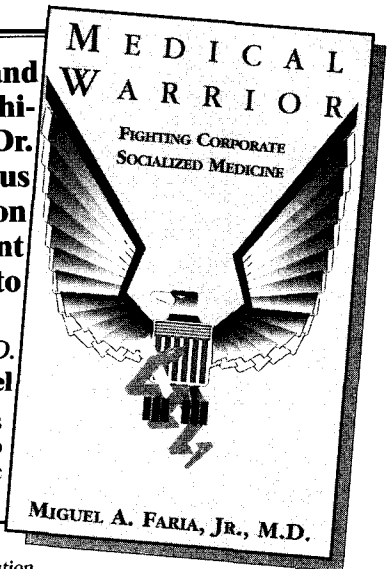

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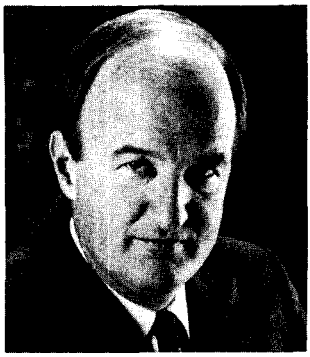

A One-Armed Economist, Please

"[W]hile purity is an uncomplicated virtue for olive oil, sea air, and heroines of folk tales, it is not so for systems of collective choice."
—AMARTYA SEN[1]

President Harry Truman hated what he termed two-armed economists, those who would advise him first "on the one hand" and then "on the other hand." Give me a one-armed economist, he demanded, an adviser who wouldn't waffle.

I was reminded of this story when I read some of the writings of the Indian economist Amartya Sen, the latest winner of the Nobel Prize in economics. He won the prestigious award (worth nearly $1 million) for his work on poverty, famine, inequality, growth theory, human rights, and ethics, all those wide-ranging debate topics common to development economics.

Writing on these topics is commendable; I just wish I knew what he was saying. Sen is one of those economists that Truman complained about. He represents everything that is wrong-headed about modern economics, which Peter Drucker has rightly described as "clever, brilliant, and bankrupt economics."[2]

Too Much Sen

Sen has all the establishment credentials. He's taught at Harvard and Cambridge and was president of the American Economic Association in 1994. His mentors are Joan Robinson, Kenneth Arrow, and philosopher John Rawls. A prolific scholar, Sen has written and read everything imaginable on his favorite subjects. He cites dozens and dozens of authors. He engages in heavy mathematical modeling and game theory. He weighs the pros and cons of every nuance of high theory. And yet, when it comes to his own view, he never seems to come to a simple conclusion. For Sen, everything is complex and indeterminate.

For example, in 1985 he gave a series of lectures at Cambridge University, subsequently published as *The Standard of Living* (Cambridge University Press, 1987). Is it possible to measure and compare living standards between individuals or nations? Sen is never sure. In his works on inequality, he rejects utility-based comparisons of income and even distinguishes between "well-being" and "standard of living." When you're through reading Sen, you feel like joining the pure subjectivists-relativists. In an often-cited article, "Rational Fools," Sen offers a critique of utilitarianism and self-interest, saying at one point, "this approach presumes both too little and too much."[3] Only in Sen's world would that be possible.

The only case I know where Sen establishes a clear position is on famines, an area he

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knows firsthand. Liberal democracies, he says, avoid famines. "In the terrible history of famines round the world, no substantial famine has ever occurred in a democracy."[4]

In trying to be ultra-scholarly, Sen obfuscates more than he elucidates. As Sylvia Nasar wrote in the *New York Times* (October 15, 1998), Sen is "highly influential, but wide-ranging, diffuse, lacking a single killer theorem." The Chinese philosopher Lin Yutang put it best, "If one is too well-read, then one does not know right is right and wrong is wrong."[5]

"One-Armed" Bauer

Give me a one-armed economist! In development theory, that candidate would be Lord Bauer. Whether you agree with him or not, you have no doubt where he stands. He is an ardent polemicist in defense of democratic capitalism (including private property, free trade, and limited government) in developing countries.

P. T. Bauer is a long-time dissenter in development economics who has finally been vindicated. In that sense, he follows in the footsteps of other free-market economists—including Milton Friedman, who was ultimately proven right about the efficacy of monetary policy, and Ludwig von Mises and F. A. Hayek, who accurately predicted that socialist central planning could never work.

In the postwar period, Bauer waged a lonely battle against foreign aid, comprehensive central planning, nationalization, and other anti-market schemes. He denied the then-current orthodoxy, such as the vicious cycle of poverty and W. W. Rostow's stages of economic growth. Today even Rostow admits, "there are, evidently, serious and correct insights in the Bauer position; for example, the shrewd and quick responsiveness of farmers to incentives and disincentives, the superiority of competitive private over public trading systems."[6]

Like Sen, Bauer has extensive experience in the developing world, having spent years in Asia and Africa as a writer and consultant. He warned the Indian government repeatedly that its five-year plans would never achieve their lofty goals. (The only Indian economist he respected was B.R. Shenoy, a lone dissenter.)

The IMF could learn a lot from reading Bauer's classic textbook, *The Economics of Under-Developed Countries*, co-authored by B.S. Yamey (Cambridge University Press, 1957). And one of the best short essays ever written is "The Lesson of Hong Kong."[7] Other essays can be found in *Dissent on Development* (Harvard University Press, 1976) and *The Development Frontier* (Harvester, 1991). The Cato Institute recently published a book, *The Revolution in Development Economics*, edited by James A. Dorn, Steve H. Hanke, and Alan S. Walters, that was dedicated to Lord Bauer and includes many of his articles. Nothing could be better, short of a Nobel Prize. □

1. Amartya K. Sen, *Collective Choice and Social Welfare* (San Francisco: Holden-Day, 1970), p. 200.

2. Peter F. Drucker, *The Unseen Revolution* (New York: Harper & Row, 1976), pp. 114–15.

3. Amartya K. Sen, "Rational Fools: A Critique of the Behavioral Foundations of Economic Theory," cited in H. Harris, ed., *Scientific Models and Men* (New York: Oxford University Press, 1978), pp. 317–44.

4. Amartya Sen, *Prospect*, October 1995, cited in Chris Patten, *East and West* (New York: Macmillan, 1998), p. 198.

5. Lin Yutang, *The Importance of Living* (New York: John Day Company, 1937), p. viii. Yutang's profound book has recently been reprinted by William Morrow. I highly recommend it.

6. W.W. Rostow, *Theorists of Economic Growth from David Hume to the Present* (New York: Oxford University Press, 1990), p. 386.

7. P. T. Bauer, "The Lesson of Hong Kong," *Equality, the Third World and Economic Delusion* (Cambridge, Mass.: Harvard University Press, 1981).

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BOOKS

New Schools for a New Century: The Redesign of Urban Education

edited by Diane Ravitch and Joseph Viteritti

Yale University Press • 1997 • 320 pages • $30.00

Reviewed by George C. Leef

Socialism cannot work, Ludwig von Mises argued from the 1920s until his death, because of a central flaw—the lack of market prices. Socialists argued back that they could simulate market prices, but Mises countered that *pretending* to have a market could never come close to the real thing. Following the collapse of communism in Europe, even some hard-core statists admitted that he had been right.

What does that have to do with a book on education in the United States? The two cases are remarkably similar. Socialism necessarily produces poor results because it does away with the market. No amount of tinkering can change that. Likewise, "public education" (another of those mushy phrases that get in the way of clear thinking) necessarily produces poor results because it does away with the market.

In place of property rights, competition, entrepreneurship, and the search for profit, the socialization of education gives us coercion, bureaucracy, taxation, and the search for political power. The incentives for quality and efficiency that drive market participants are diminished and perverted when schools and educators do not derive their revenues from willing customers, but instead derive them through the tax system. That's the ineradicable, disastrous flaw in "public education." Market-imitating reforms in education are a shabby substitute for the market itself.

This book, edited by Diane Ravitch, a Brookings Institution scholar, and Joseph Viteritti, a New York University professor of public administration, is typical of the books by educational theorists who, like the socialist intellectuals, know that the system isn't working, but want to modify and improve it without giving up on the system itself. While there are many insightful points in the ten essays included, not one grapples with the fundamental problem: turning education from a private investment into a government entitlement ensures politicization and decay. Popular ideas such as charter schools, contracting, vouchers, and choice abound, but conspicuously missing is any radical, Mises-like author arguing against continued reliance on government education.

What I regard as the best essay in the book, Chester Finn's "The Politics of Change," comes rather close to arguing that trying to reform public education is a lost cause. He recounts numerous episodes in which defenders of the system defeated changes that even remotely threatened their beloved *status quo.* Consider, for example, the reaction of the New Jersey education establishment when PepsiCo announced its participation in a program to provide scholarships to poor youngsters so they could get out of the Jersey City public schools. Suddenly, the company was faced with a union-instigated boycott of its products, and there was a mysterious wave of vandalism aimed at its vending machines. Pepsi backed down. The education establishment presents a smiling face to the public, but turns into a pack of snarling Dobermans when anyone comes near its turf.

Far worse is the incessant thought-control campaign waged by the educational establishment. Finn writes that it "cleverly manipulates Americans' strong affection for the concept of public education while imposing a double standard on proposals to reform its reality." The propaganda organs never stop informing voters that "their" schools are *award-winning, progressive,* and *improving.* Furthermore, they automatically label any proposed change that doesn't involve more money and authority for the schools *anti-education.* This works marvelously; opinion polls show that the great majority of parents are satisfied with the public schools their children attend and leery of "dangerous" changes.

When all else fails, the public education crowd resorts to political intimidation. Finn

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recounts how one of those market-imitating reforms was beaten in Arizona when the education lobby persuaded several Republicans in swing districts that it would be wise for them to vote against the bill.

From this essay, one might conclude that the prospects for significant change in—much less the defeat of—public education through the political system, are nil. Finn is not quite so pessimistic, noting some "cracks in the glacier." He acknowledges, however, that a glacier can continue on, grinding down all in its path, even with some cracks in it. Perhaps people who care about education should just give up on the political process and concentrate instead on creating a modern version of the Underground Railroad to help children escape from the public education trap.

If you want to know more about the problems and prospects of the Milwaukee school-choice plan, what has become of the Edison Project, or the battles over public school contracting, this book will serve you well. If you want to raise your blood pressure over the venality of the teachers unions and their political supplicants, this book will get you hot under the collar. But if you want a book on education that challenges the prevailing wisdom that public education is both necessary and reformable, look elsewhere. □

George Leef, president of Patrick Henry Associates: Liberty Consultants in East Lansing, Michigan, is book review editor of The Freeman.

Those Dirty Rotten Taxes: Tax Revolts that Built America

by Charles Adams

The Free Press • 1998 • 242 pages • $25.00

Reviewed by James A. Woehlke and Nikolaus P. Woehlke

IRS reform has been a hot topic in Washington recently. Last spring, more than 80 legislators attempted to repeal the Internal Revenue Code—unsuccessfully. Fundamental tax reform, the attempt to replace the graduated income tax with a flat tax or national sales tax, was a guiding theme for the newly elected reformist Republican Congress in 1995. Although the ponderous tax code is still very much alive, its future is in doubt.

In this legislative milieu, Charles Adams has unleashed his new book, *Those Dirty Rotten Taxes*, in which he shares his view of American history as a hotbed of tax revolt. The book tells of the injustice and oppression wreaked by tax collectors, and shows how tax avoidance and revolts have influenced our current tax system.

The book abounds in historical detail. For instance, the whiskey rebellion of 1794: farmers were unfairly taxed for producing whiskey, which for some was the only viable means of transporting their corn. The farmers quickly rebelled and refused to pay the tax. The new federal government, which had only recently been founded on, among other things, the principle of fair taxation, responded harshly by sending an entire army, led by President George Washington in general's garb, to force the farmers into compliance.

Adams emphasizes the role taxes played in causing the Civil War. The Republican Party's key plank in the 1860 election was the imposition of a severe tariff, a disguised subsidy to northern industry that would have hurt the agrarian southern economy. Adams argues that the concessions Lincoln offered the South on the issue of slavery—including a constitutional amendment that would have preserved the "peculiar institution"—prove that economic exploitation of the South was a more significant cause of the war than was slavery. His view of the War Between the States makes this a particularly thought-provoking counterweight to the typical U.S. history text, which presents slavery as the prime cause of the war.

American history includes another tax on whiskey that led to yet another whiskey insurrection, this one a small-scale war between the moonshiners and the revenuers that began shortly after the Civil War. (At this point, the reader has to wonder if Americans were characterized more for their hatred of taxes or their love of good whiskey!) This whiskey rebellion can be regarded as successful, since the government chose to repeal a tax that the people simply wouldn't pay.

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Adams then comes to the ugliest monster of them all, the income tax. He blames it for intruding into the private lives of citizens and chasing some of our most prosperous businessmen out of the country. For Adams, the IRS is an abomination. He reveals, for instance, that it paid agents according to how many foreclosures they caused. How quick the IRS has been to take cars, homes, or money, yet unbearably slow to fix its mistakes or the damage it caused to innocent people's lives! Adams also discusses the high death tax and how it causes the elimination of over 90 percent of family businesses after the founders die.

Those Dirty Rotten Taxes makes a strong case for abandoning intrusive direct taxation to the greatest extent possible. Adams, like the Founders before him, prefers indirect taxation, such as a sales tax, and so is no fan of any of the various flat tax proposals.

Those Dirty Rotten Taxes is not a rigorously documented book, unlike Adams's previous work, *For Good and Evil: The Impact of Taxes on the Course of Civilization*. It is lighter, and at times prone to hyperbole. But its straightforward view of the ingrained American antipathy to taxation is exhilarating. There are lots of illustrations and political cartoons, and the writing is engaging and easily understood. We highly recommend this book to anyone interested in taxes, history, or government. □

James Woehlke is counsel and director of technical services for the New York State Society of Certified Public Accountants. Nikolaus Woehlke is a freelance writer from Poughkeepsie, New York.

Enterprising Southerners: Black Economic Success in North Carolina, 1865–1915

by Robert C. Kenzer

University Press of Virginia • 1997 • xvi + 178 pages • $30.00

Reviewed by Richard M. Gamble

In this meticulous and tightly argued volume, historian Robert Kenzer corrects what he describes as the prevailing "monolithic" view of the economic condition of North Carolina blacks in the 50 years between the end of the Civil War and the First World War. By no means dismissing or even minimizing the impact of racism and the legacy of slavery in shaping the black experience in those years, Kenzer presents compelling evidence of "slow but steady progress" in land-ownership and business enterprises. Drawing imaginatively on extensive primary statistical evidence, yet going far beyond mere quantitative history, Kenzer analyzes the range of economic, cultural, and political factors that encouraged economic success among an exceptional group of blacks in the postbellum South, a success that they took pains to pass on to their children through higher education for careers in teaching, the ministry, medicine, and business.

Kenzer found that blacks' success in acquiring land, launching viable businesses, and achieving political and social leadership in their communities was related to several clearly identifiable factors, some economic, some cultural. Land-ownership, for example, was highest both in amount of and value of acreage among blacks who had been free before the war, were mulattos, held non-agricultural occupations, and lived in the more fluid real estate market of the cities. Similar patterns held true for success in business and politics. To be sure, success was not limited to blacks who fit this statistical profile, but urban blacks who had been free before the war experienced the highest degree of success as landowners, businessmen, and political leaders.

From the perspective of free-market economics, two important contributions stand out in Kenzer's work. While not the main point of his study, his observations about blacks' relationship to the market economy and their network of self-help organizations bear noting. Black leaders in North Carolina defended an open market in real estate free from government intervention and special-interest legislation. Faced with proposed legislation in 1915 designed to prevent blacks from buying land in majority-white districts, for example, black leaders argued for a free market for both blacks and whites in which to buy and sell property under the most favorable terms.

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Blacks simply wanted the freedom to acquire land and homes in an open market. Under pressure from like-minded white landowners, who did not want their freedom restricted either, the state senate rejected the bill. In business enterprises as well, black entrepreneurs proved their business savvy by their ability to adapt to changing market conditions, even in enterprises and localities formerly dominated by white Southerners. They understood that an open market was their friend, politics their enemy.

More striking is Kenzer's discussion of black leaders' efforts to strengthen their communities' economic and social well-being with a network of effective voluntary organizations. Local chapters of the Masons, for example, provided financial assistance and emotional support in times of sickness, unemployment, and bereavement. Drawing members largely from the black economic and political elite, these voluntary societies encouraged success by providing a framework of moral and ethical accountability and helpful practical experience in managing lodge assets.

To advance their business opportunities further, enterprising blacks also founded banks, building and loan associations, and insurance companies, and joined state and national black industrial organizations. The extent of black economic success that Kenzer recounts is both remarkable and at odds with the prevailing notion that post-Civil War blacks all lived in grinding poverty.

Beyond individual and collective economic success as landowners and businessmen, postbellum black elites in North Carolina also achieved a degree of political success. Beginning as loyal party members, generally in the Republican ranks but later in the Populist movement as well, blacks often held patronage jobs (such as tax collectors) before seeking elective office. They found political success as local, state, and national officeholders and, not immune to the temptations of rent-seeking behavior, used their positions to enhance their business opportunities, dispense patronage jobs, and shape tax policy.

Kenzer's history is intended for the specialist in American economic history, and the general reader may be put off by its comprehensive detail. Nevertheless, his gift for organization, his sense of narrative flow, and his effective use of telling anecdotes combine to make this an accessible study of the period even for the non-specialist. Overall, Kenzer has provided historians and economists with a convincing account of the diverse world of postbellum black success, a commendable book that is lucid, grounded in extensive archival research, conversant with the secondary literature, and a pleasure to read and learn from. □

Richard Gamble is a professor of history at Palm Beach Atlantic College.

The Costs of War: America's Pyrrhic Victories

edited by John V. Denson

Transaction Publishers • 1997 • 450 pages • $44.95 cloth; $29.95 paperback

Reviewed by Doug Bandow

Advocates of limited government have long known that war and preparation for war are enemies of liberty. War obviously destroys lives and consumes wealth—new technologies have made genocide a simple matter of pushing a button. But war has another, long-lasting consequence: it centralizes power. "War is the health of the state," observed Randolph Bourne.

Many conservatives were willing to pay this high price during the Cold War because of the threat of hegemonic communism. But now America reigns supreme internationally. Those who believe in individual liberty must work to limit government power internationally as well as domestically.

John V. Denson's *The Costs of War: America's Pyrrhic Victories* provides a desperately needed call to arms. As he explains: "[B]ecause liberty is so fragile, its true defender recognizes that war is its greatest enemy, and therefore the true patriot is often the courageous individual who opposes a particular war because he recognizes that it is unjust—that it would be fought for the wrong

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purposes or that the risk for the loss of liberty is greater than any benefit to be gained by the war."

The Costs of War emphasizes the fragility of liberty and chronicles the devastating impact of past conflicts. This comprehensive volume covers everything from the War of Northern Aggression (sometimes called the Civil War) to the role of conscription and the record of Winston Churchill.

Denson leads off with a sweeping essay on U.S. history. The nation's founders feared the costs of war, which is why they worked to prevent intervention in foreign conflicts. Their fears were well founded: the Civil War and Spanish-American War both spurred the growth of federal power. World War I, however, was a truly epochal event. Not only did the national government institute mass conscription and seize control of the economy, but, as Denson relates, "President Wilson followed Lincoln's example and ruthlessly crushed the civil liberties of those Americans who opposed his war." Although government power receded some after the conflict, World War II and the Cold War fueled state growth anew.

The lack of serious opposition to warlike policies today conflicts with America's long anti-interventionist tradition, of which Justin Raimondo, of the Center for Libertarian Studies, writes: "It wasn't just the founders who opposed fighting other people's wars. There was strong opposition to the Spanish-American War and World War I—which is why Wilson resorted to jackboot tactics against his critics."

What makes *The Costs of War* particularly valuable is its willingness to slaughter sacred cows. Such as Abraham Lincoln and his war for the Union—which ended up killing more than 600,000 people, distorting the constitutional order, and violating civil and political liberties. History professor Richard Gamble explores Lincoln's ugly legacy of the "destruction of the old Republic, a more modest federation with a regard for localism and states' rights, a sense of limits, and a relative freedom from foreign entanglement."

Equally subversive, but also persuasive, is the analysis of Winston Churchill's record by historian Ralph Raico. There is perhaps no more venerated figure from World War II, but Raico's view is rather less positive. He contends that "Churchill was from first to last a Man of the State, of the welfare state and of the warfare state." Indeed, argues Raico, war "was his lifelong passion." This is the record that virtually no one knows.

Some of the impacts of war are unintended and even unimagined. Allan Carlson of the Rockford Institute explains how war swells the state; in turn, "as the state grows, the family declines." He warns that the military today is "being used to re-engineer our society to serve the total state." He therefore calls on conservatives to "cast off lingering delusions about the 'conservative traditions' of the military."

Real patriotism means risking the lives and wealth of Americans when their future as a free people is at stake. *The Costs of War* illustrates why there may be no more important duty today for advocates of limited government than to steadfastly oppose war. □

Doug Bandow is a senior fellow at the Cato Institute and author of Tripwire: Korea and U.S. Foreign Policy in a Changed World. *He formerly served as a special assistant to President Reagan.*

Enviro-Capitalists: Doing Good While Doing Well

by Terry A. Anderson and Donald R. Leal

Rowman & Littlefield Publishers, Inc. • 1997 • 189 pages • $52.50 cloth; $16.95 paperback

Reviewed by Bruce Yandle

Writing about Austrian economics and the market process, Israel Kirzner explains how entrepreneurs play a crucial role in discovering products, markets, and processes for improving human welfare (*Journal of Economic Literature*, March 1997). The interesting aspect of all this is *surprise*. In Kirzner's view, entrepreneurs identify profit opportunities that, once revealed, seem rather simple and obvious. An accompanying expression of surprise usually charac-

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terizes the outcome. The question "Why didn't I think of that?" is more common than the statement "Boy, that surely is complicated; I can't imagine how they came up with it."

Paper clips with wrinkles, self-serve supermarkets, moving assembly lines applied to auto production, Post-It notes—all relatively simple things that reflect a combination of imagination and market savvy. This is the stuff that built America's market economy. Is it possible for this same creative energy to provide improved environmental quality?

Readers of *Enviro-Capitalists: Doing Good While Doing Well,* by economists Terry Anderson and Donald Leal, will be convinced that the same unquenchable entrepreneurial spirit that delivers an abundance of food, clothing, communications, health, and other critical features of life can be relied on to deliver environmental quality—if only entrepreneurs could be encouraged rather than delayed and discouraged by government action.

The authors do not dwell on theories and assertions about free-market environmentalism. Instead, they recount fact-filled stories about past and present activities of enviro-capitalists. Those who erroneously cling to the idea that capitalism is inherently destructive to the environment will find their prejudices strongly challenged. This collection of stories about real people and their profit-making ventures in environmental production reminds us again that capitalism works.

We learn, for instance, about Joseph Crisafulli, a successful entrepreneur in Glendive, Montana, who established a paddlefish roe enterprise. He discovered that paddlefish roe would pass the market's test for caviar. Sensing a profit opportunity, Crisafulli and other town business people began a paddlefish cleaning service for fishermen who prize the fish but dislike cleaning them; they obtained pounds of valuable roe in the bargain.

However, Crisafulli and his associates had to work through a deep political bureaucracy. They needed permission from both state and federal regulators before beginning their enterprise. Moreover, the regulators insisted that net proceeds go to "community improvements" including the preservation of the habitat of the fish. They consented to these dictates, which happened to largely coincide with their plans, but it is easy to imagine that bureaucratic red tape and micro-management could easily stifle other environmental projects.

Another case the authors discuss is International Paper's realization that large amounts of its forestland produced more wealth when managed and maintained as wildlife habitat and recreational space than when used as a source for cut timber. This led the firm to allocate more than a million acres of land to those purposes. Why did International Paper do it? The same reason that causes the firm to search for lower-cost paper and timber products—profit. Market forces are delivering environmental quality.

What about Yellowstone, that paragon of America's park system? Was it the unblemished foresight of government that preserved this collection of natural wonders? Hardly. Instead, we learn that "robber baron" railroad capitalists recognized the market value of the territory that became Yellowstone Park. Seeing a promising attraction for eco-tourism and rail traffic, railroad capitalists sought to purchase the land from the federal government, but were prevented from doing so by an egalitarian federal law limiting land ownership to only 160 acres. Frustrated in their attempt to purchase the asset they wanted, the railroaders then lobbied for Congress to establish Yellowstone National Park and once it had done so, they promptly built the rail lines and hotels.

Anderson and Leal also explain how entrepreneurs are finding market niches for protecting endangered species, such as the peregrine falcon. The common assumption that government action is the only means to protect species cannot survive a reading of this book.

Enviro-Capitalists should be read both by environmentalists and friends of liberty. True environmentalists, those who seek to protect the precious biological envelopes that support life and are not simply dedicated to the replacement of individual freedom with command-and-control regulation, will be encouraged to know that markets are on their

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side. Friends of liberty, who sometimes find themselves hard-pressed to defend markets in the face of attacks from environmentalists, will welcome the reinforcements provided by this excellent, if too-short book. □

Bruce Yandle is Alumni Professor of Economics and Legal Studies at Clemson University.

Higher Superstition: The Academic Left and Its Quarrels with Science

by Paul R. Gross and Norman Levitt

Johns Hopkins University Press • 1997 • 314 pages • $35.95 cloth; $16.95 paperback

Reviewed by Thomas F. Bertonneau and Richard L. Cutler

Science, along with the technology that develops out of it, is a unique and vital source of the high civilization in which we dwell. Science is enthroned as the reigning model of Enlightenment thought; the methods of science represent an epistemology involving objectivity, real-world absolutes, and the pursuit of truth through hypothesis, observation, validation, replication, and prediction. Science presents an ordered, reasoned, rigorous world marked by precision, unambiguous definition, and the established rules of logical argument.

If science is the monarch of our worldview, however, it is increasingly the target of would-be revolutionaries and regicides—members of what Paul Gross (professor emeritus of life sciences at the University of Virginia) and Norman Levitt (professor of mathematics at Rutgers University) identify as the "academic left," who insist that there are no absolutes, that objectivity is a fiction used by vicious oppressors, and that the world is essentially chaotic.

Higher Superstition is a defense of science against attempts by badly informed nonscientists to dethrone and discredit the Western tradition of scientific investigation. They were not satisfied with their deconstructive wastelaying among the treasures of Western art and literature. They make the same claims, say, for Newton and Darwin as they do for Shakespeare and Melville: all authority and claims to truth are but shams whose only purpose is to protect the unjust distribution of power that earmarks our "oppressive" society. Feminists, for example, indict Newton for attempting to master the universe by constraining it under "patriarchal" laws and Darwin for his "male" notion of the survival of the fittest.

Gross and Levitt note that claims of this type are not entirely new—prototypes may be seen in Rousseau and Blake—but they argue that in America's colleges and universities the anti-science ideology has grown dangerously influential. Academic careers are now built on jeremiads against "sexist" canons of proof-through-replication and the alleged exclusion of women (that is, feminists) from scientific debate. Ideas that used to be regarded as the rantings of reactionaries now find fulsome praise in the tracts of academicians who claim to be in the vanguard of radical liberation.

When one remembers the distortions that Soviet biology suffered under Lysenko's Stalinist genetics, it becomes clear that the real conflict is not between reactionism and science but between power-mongering and science. It is no coincidence that the left-wing professors who think that they can play the same games with the third law of motion that they do with Virgil and Shakespeare generally follow Michel Foucault, a pseudo-Nietzschean who claims that there is no knowledge, only power, and that those who have power are, a priori, evil. That this position entails a claim of knowledge and that its exponents themselves wantonly seek the very power that they denounce never enter the argument.

Nuttiness among intellectuals flourishes perennially. So tight is the grip of the left on institutions of higher education, however, that Gross and Levitt fear an impending struggle in which affirmative action will force science departments to change their practices under naked political pressure. The authors also see another problem. Real science is so badly taught to undergraduates that many get only "science studies" courses concocted by the postmodern anti-scientists. Gross and Levitt decry the trendiness of schools of education that have embraced anti-science and that send

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into K-12 schools newly certified teachers whose knowledge of physics, chemistry, and biology is nugatory.

In their penultimate chapter, the authors speculate on the psychological origins of anti-science. They trace the pretensions of the feminists, earth-worshipers, and "deep ecologists" to resentment. Precisely because science succeeds, and because it so impressively informs the daily reality of modern life, the intelligentsia feel diminished; they exercise no similar influence. A feeling of inferiority breeds petulance, manifested in puffed-up vocabularies, moral posturing, and a need to disparage. Those who hate the West because they despise their own paltriness naturally attack science and scientists as ready scapegoats.

Representatives of the sciences, Gross and Levitt say, have too long stood on the sidelines, amused perhaps by the display of folly. The time for that is over; the folly portends real danger. Science must begin to answer the absurd but pernicious claims of anti-science, if only to remind the public that the strutting peacocks of postmodernism are not free from chastisement, and that their fantail of claims collapses—epistemologically speaking—at the pressure of a glance. □

Thomas Bertonneau is the author of Declining Standards at Michigan Public Universities *and teaches literature at Central Michigan University. Richard Cutler is president of the Michigan Association of Scholars and a former vice president of the University of Michigan.*

Between Power and Liberty: Economics and the Law

edited by Richard M. Ebeling

Hillsdale College Press • 1998 • 169 pages • $9.95 paperback

Reviewed by Philip R. Murray

Between Power and Liberty: Economics and the Law, is the publication of the 1997 Ludwig von Mises lectures at Hillsdale College. The book's title comes from James Madison's description of the Constitution and the Bill of Rights: "every word . . . describes a question between power and liberty."

The essays in this book brilliantly make the case for liberty over power. Three key points emerge: First, that private property is the key to individual liberty. Second, that the Constitution was intended to protect private property against government intrusions. And third, that we have reasons to be optimistic, despite the panoply of governmental restrictions on our private property and individual liberty.

Richard Ebeling, chairman of Hillsdale's economics department, contrasts "The Free Market and the Interventionist State." The role of government in a free society, he argues, is to protect private property, maintain order, and thus maximize the incentive to create wealth. Interventionism violates property rights so that government officials can redistribute wealth according to their own plans. Ebeling laments the conception of "public policy" as synonymous with government intervention. Discussions of public policy almost always center on "What can the government do?" instead of "What can we do as individuals?" or even "What did the government do to get us in this mess in the first place?" Ebeling explains how to defend the free market against attacks based on spurious economic theory, "social justice," and "the public interest." Those who wish to improve their ability to defend the market will learn much from his essay.

Several of these lectures make an excellent introduction to constitutional economics. Hillsdale President George Roche notes that the Declaration of Independence proclaims the "unalienable Rights" of individuals, as opposed to the idea that rights are grants from the state. He outlines the economic philosophy of the Constitution: that government taxation, borrowing, and spending should be kept to a minimum and that government should permit free trade to grow.

Cato Institute fiscal analyst Stephen Moore calls the Constitution "A Rulebook for Government." He says that "No matter how long one searches, it is impossible to find in the Constitution any language that authorizes at least 90 percent of the civilian programs that Congress crams into the federal budget." Moore relates that early in our nation's histo-

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ry members of Congress and presidents used to reject even charitable acts of government spending as unconstitutional. What led to the current high levels of government spending? The Sixteenth Amendment (which permitted a federal income tax), a glaring misinterpretation of the "general welfare" clause of the Constitution, and the New Deal.

No discussion of economics and the law would be complete without recognition of the great French economist Frederic Bastiat. Harry Browne explains Bastiat's definitions of "the law" and "the law perverted." The law protects life, liberty, and property. The law perverted transfers property. For example, Social Security taxes the income of workers and transfers it to retirees. The law perverted plunders people rather than protecting them. What are the results of using the political process instead of the market process to achieve what we want? Roche puts it well: "The average person no longer looks to his own talents to get ahead; he looks to the state."

Despite the reduction in our property rights and the corresponding loss of liberty, we have reasons to be optimistic about the future. In his essay, "The Grassroots Legal Reform Movement," Clint Bolick of the Institute for Justice recounts his organization's successes in eliminating restrictions on economic liberty through constitutional litigation. Likewise, Bernard Siegan sees promise in a revival of the "takings" clause of the Fifth Amendment, which bars government from taking property without paying for it.

Perhaps the most valuable contribution these lectures make is their emphasis on self-government. It is primarily the duty of each citizen to restore liberty through the practice of self-government. This means refusing to take assistance from government and using our own talents in conjunction with the voluntary cooperation of others to live the free, responsible life. □

Philip Murray is an associate professor of economics at Webber College in Babson Park, Florida.

The Foundations of Morality

by Henry Hazlitt

In this impressive work Hazlitt explores the proper foundation of morality. It would give the game away to reveal his conclusion, but suffice it to say that Hazlitt conducts a detailed and scholarly inquiry into the many possibilities.

Leland B. Yeager, noted economist, has written a new foreword to the book, in which he says that *The Foundations of Morality* "provides (in my view) the soundest philosophical basis for the humane society that is the ideal of classical liberals."

This challenging work on ethics fits in the great tradition of Adam Smith's *Theory of Moral Sentiments* and David Hume's *Treatise of Human Nature*. It is a well-reasoned, tightly argued book that amply rewards its readers.

398 pages Regular Price: ~~$18.95~~ Sale Price: **$14.95**

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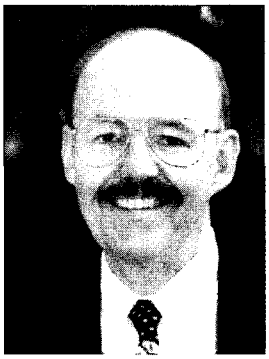

The ILO's Strange Use of Words

Last June the International Labor Organization (ILO) put forth its "Declaration on Fundamental Principles and Rights at Work." U.S. Labor Secretary Alexis Herman asserted that the declaration is "a big step forward for the ILO and its members as we enter the 21st century." John Sweeney, president of the AFL-CIO, called it "an historic breakthrough that dramatically underscores the importance of basic rights for workers in the global economy."

The core of the declaration requires the governments of all ILO member countries "to promote and to realize, in good faith" four basic principles: "(a) freedom of association and the effective recognition of the right to collective bargaining; (b) the elimination of all forms of forced or compulsory labour; (c) the effective abolition of child labour; and (d) the elimination of discrimination in respect of employment and occupation." Forty-three developing countries refused to support the declaration because they saw it as an attempt by industrialized countries to eliminate their competitive advantage in labor costs and as a pretext for the imposition of protectionist trade restrictions. They were right. That, I submit, is what makes Herman and Sweeney tingle all over.

While all classical liberals can enthusiastically agree to item (b) in the declaration, item (c) is problematic. Today's industrialized countries abolished child labor by statute only after labor productivity had risen to the point that markets had abolished it by choice. Item (d) is also problematic because of the wide variety of meanings attached to the word "discrimination." In the United States, for example, most so-called civil rights leaders say that it is discriminatory not to discriminate. Moreover, elimination of discrimination in employment by law often means legal mandates to pay equal wages for labor services of unequal value.

However, most problematic of all is item (a). What does it mean? If "freedom of association" means that government is forbidden to interfere with individuals who wish to affiliate with each other for legal purposes, or to interfere with other individuals who choose not to enter into such affiliations, then I concur. If "collective bargaining" means voluntary bargaining involving individuals who have each chosen to be represented by the same agent, then I concur.

A brief glimpse at ILO documents through the years, however, shows that this is not what the organization means.

Its definitions of these terms are made clear in the 1994 report of its Committee of Experts, "Freedom of Association and Collective Bargaining," and in how its Committee on Freedom of Association applied these principles in its 1994 evaluation of New Zealand's Employment Contracts Act (ECA).

The Committee of Experts wrote that "trade union rights violations may . . . result by reason of legislation . . . which favour[s]

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individual rights to the detriment of collective rights." This distinction between individual rights and collective rights is curious. Human rights reside in individuals. They are prior to government, and it is government's duty to protect them for all individuals. Individuals can voluntarily associate with each other in the pursuit of legal ends, but the association is nothing more than the sum of its constituents. It can have no rights other than the rights that its individuals bring into it, and those individuals have exactly those rights that all individuals have, no more and no less.

The ILO endorses rights to trade-union association that are distinct from, and in conflict with, individual rights to free association. It asserts that those who wish to join trade unions must be free to do so, but it does not say that those who choose not to join, be represented by, or to pay union dues should be free to abstain. In 1947 the ILO rejected an amendment to its Convention No. 87, "Freedom of Association," that would have "grant[ed] workers the right not to join an organization." But correctly understood, freedom of association means just that. Likewise, the Experts endorse the principle of exclusive representation, under which unions are granted the legal privilege of representing workers other than their voluntary members. They also espouse union security, which means workers can be forced to join unions or at least to pay union dues.

Article 4 of the ILO's Convention No. 98, "Right to Organize and Collective Bargaining," states, "Measures . . . shall be taken . . . to encourage and promote the full development and utilization of machinery for voluntary negotiation between employers or employers' organizations and workers' organizations." This sounds good but it's not what it seems. First, note that individual employers can bargain with workers' organizations, but there is no provision for individual workers to bargain with employers. The word "voluntary" doesn't apply to workers who choose to bargain for themselves. Furthermore, the Experts approve mandatory good-faith bargaining between trade unions and employers. Under this principle employers are forced to bargain with unions and to make concessions to unions. The word "voluntary" in Article 4 is meaningless.

New Zealand's ECA became law in 1991. It eliminated almost all forms of compulsory unionism. Individual workers are free to decide whether to represent themselves or to authorize an agent to represent them. Agents can be unions, individuals, or non-union organizations. While employers must recognize agents chosen by individual workers, they do not have to bargain with them. Unions may represent only workers who choose to join. There can be no forced membership or forced dues. Employers and workers are free to choose whether to enter individual or collective contracts. In 1993 the New Zealand Council of Trade Unions complained to the ILO that the ECA violated Conventions 87 and 98 on freedom of association and the right to collective bargaining. The 1994 "Report of the Committee on Freedom of Association" that evaluated the complaint speaks for itself: It could not accept the ECA's "underlying philosophy, which puts on the same footing (a) individual and collective employment contracts, and (b) individual and collective representation."

Imagine that! The ECA "allows" workers freely to choose to negotiate employment contracts individually or collectively. But the ILO doesn't approve. It prefers "promoting and encouraging" (read "coercing") mandatory good faith collective bargaining through trade unions vested with collective rights that trample individual rights.

This is Secretary Herman's "big step forward into the 21st century" and John Sweeney's view of "basic rights for workers in the global economy." In reality the ILO's views are based on the nineteenth-century idea of class struggle and the twentieth-century illusion that the working class needs compulsory trade unionism to defend itself against predatory employers. In my view the ECA is the real giant step forward into the 21st century precisely because it is based on *genuine* rights. □

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"The functionaries of every government have propensities to command at will the liberty and property of their constituents."

—THOMAS JEFFERSON, letter to
Charles Yancey, January 6, 1816

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